



LOCAL GOVERNMENT FINANCE

Appendix 8

*to the Report of the Committee of Inquiry
under the Chairmanship of Frank Layfield Esq qc*

Local Income Tax: Evidence and Commissioned Work

LONDON
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LOCAL GOVERNMENT FINANCE

Appendix 8

to the Report of the Committee of Inquiry

CORRECTION

The following text should be inserted after page 114. It should be read in conjunction with the Inland Revenue's written evidence "Local Income Tax: Costs, Staffing and Timescale" (page 113) and with the transcript of the Inland Revenue's oral evidence to the Committee on 13 October 1975 (page 182)

LOCAL INCOME TAX—SUPPLEMENTARY EVIDENCE

DECEMBER 1975—JANUARY 1976

1. Following the Committee's third oral evidence session with the Board of Inland Revenue on 13 October 1975, and the Board's supplementary evidence of 31 October there were further exchanges of letters between the Committee and the Board in December 1975 and January 1976. This note, which has been prepared by the Committee and agreed with the Board, summarises the outcome of these exchanges.
2. Following their evidence in October 1975, the Board offered to consider the feasibility of separate LIT rates being set by different numbers and types of local authorities. They also offered to review their estimates of staff requirements. As a result of this review the Board concluded that it would be feasible, although difficult, for the rates of LIT to be varied by counties and Scottish regions or by the Greater London Council and major spending authorities outside London, that is, non-metropolitan counties and metropolitan districts in England and Wales and regions in Scotland. They considered that it would be very difficult to vary the rates of tax within the Greater London Council area and expressed doubts about the practicability of doing so. The large number of district authorities outside metropolitan areas would make it impracticable for LIT to be allocated to them individually.
3. The Inland Revenue estimated that if separate tax rates were set by counties and Scottish regions about 12,000 staff would be required for assessment and collection. If the tax rates were set by major spending authorities the staff requirement would be between 12,000 and 13,000.
4. These estimates are dependent on the national tax system being simplified by finding other channels through which to achieve the results now given by child tax allowances, mortgage interest relief, life assurance relief, and if possible the other minor personal tax allowances. The reduction in the staffing requirement for LIT compared with earlier estimates is not, however, due to this simplification of the national tax system and the saving in staff which it would permit has not been taken into account. The revised staffing figures for LIT are due to assuming the adoption of a local tax system designed to reduce the administrative costs to a minimum. The Inland Revenue indicated that such a system would have the following characteristics:

- (i) liability would depend on residence at a particular date, which would not be less than 12 months in advance of the start of the relevant tax year: this time lag would be necessary to fit an LIT into the Inland Revenue's annual cycle for the issue of tax returns;

- (ii) the normal issue of tax returns would be made, as now, in April of each year, and tax returns would incorporate a declaration of residence. Those taxpayers not sent tax returns (not everyone is sent a return every year) would get a residence return instead;
- (iii) tax offices would not issue a separate notification of residence to the taxpayer. For PAYE taxpayers the rate at which local tax would be payable in the coming tax year would be indicated by a suffix to the PAYE code number, which is notified to the taxpayer at about the turn of the year (December/January);
- (iv) the employer would operate PAYE tables which incorporated the national tax rate with a given local tax rate; how many different sets would be required would depend on the range of local tax rates. The suffix to each individual's code number would tell him which PAYE table to use in each case;
- (v) as regards the individual taxpayer, he would not get a breakdown of his liability as between national tax and local tax, whether in the PAYE deductions shown on his payslip or if an assessment was made. But he would know what his local rate was from publicity by his local authority, and he would be able to check from his PAYE coding that the right rate had been allocated to him;
- (vi) for the person paying tax under Schedule D, it would be for him to check when he received his notice of assessment that the rate of tax charged represented the national rate plus his appropriate local rate;
- (vii) so far as investment income is concerned, the law would be changed to require the deduction of tax at source on a much wider basis than at present: "coding out" for the PAYE taxpayer would completely disappear and direct assessment would be very rare. The rate would be a combined one representing the national rate plus a flat LIT rate. Where exceptionally direct assessment of investment income was still required, this would be at the flat rate and not a local rate. (The net effect of these changes would be a staff saving as compared with the existing state of affairs);
- (viii) the revenue paid over to local authorities would be fixed on the basis of an annual statistical survey, and there would be no allocation of the LIT actually deducted. Because this survey would have, *inter alia*, to show a split between earned and investment income in each area, it would need to be on a fairly large scale;
- (ix) the tax base—i.e., the amount on which income was charged—would be the same for LIT as for national tax;
- (x) only individuals would be liable to LIT; the tax would not be payable by companies.

5. The Committee sought further advice from the Inland Revenue on the timing of the determination of residence (see paragraph 4 (i)), and the timing of the determination of LIT rates (see paragraph 4 (iii)). Annexes A and B attached set out the Inland Revenue's response to these particular aspects of LIT practicality. At Annex C is a memorandum from the Inland Revenue which discusses the implications of calculating LIT payable by the taxpayer by expressing LIT as a percentage of national income tax due.

COMMITTEE OF INQUIRY INTO LOCAL GOVERNMENT FINANCE

March 1976.

ANNEX A

TIMING OF THE DETERMINATION OF RESIDENCE FOR LIT PURPOSES

Memorandum by the Inland Revenue

1. The Committee are concerned at the 12 month time lag in our outline scheme between the date of the determination of residence and the start of the tax year for which the determination would take effect.

2. As explained we have proposed this arrangement to enable work on residence to be co-ordinated with and merged in the annual cycle of work in tax offices as far as possible. Any putting back of the date by reference to which residence is established would entail a large scale duplication of effort, and the setting up of work processes which could not be integrated with the PAYE annual work cycle.

3. It is clearly desirable to incorporate the resident indicator, whatever form it takes, within the PAYE code, in such a way that both employee and employer get one piece of paper which shows both items. For this to be feasible, it would not be possible to reduce the lead time below 6 months. This would be the minimum time necessary to allow for the issue, receipt and examination of residence returns, and the settlement of at least the more straightforward disputes. Even so, there would overall be a very large number of cases unsettled at the start of the next tax year, and to the extent that they could be settled in the next 6 months, this would give rise to extra work on in-year code adjustments, and complaints, which could otherwise have been avoided.

4. If the lead time were shortened by about half by determining residence by reference to the position obtaining at 30 September in the preceding year, we would have to issue residence returns to everyone in October. The number issued would be substantially greater than under our outline scheme because a separate residence return would now be issued to everyone even if they had received a tax return the previous April. This would entail the issue and receipt each year of about an extra 8 million forms—with complaints from the public because they had to fill in two forms.

5. Most of the 20 million or so residence returns which it would be necessary to issue under this arrangement would probably come back within 3 or 4 months of issue. They would have to be examined and residence determined over this period. But the examination of tax returns is largely completed by October. The final months of the calendar year are devoted to the crucial process of determining codes for the following year in the light of the personal allowances etc which have been established in the previous examination of returns, and then writing notices of coding with the object of completing the issue early in the new year to allow time for appeals to be settled before the start of the tax year. So if residence returns had to be issued and examined in this period, tax offices would be faced with a substantial amount of extra work at what is already a very busy time of year. This "peaking" problem would be exacerbated by the need for constant revision of codes already fixed and coding notices already written or issued in the light of the later information revealed by residence returns as they came in and were examined. In cases of dispute, or returns received late, this process of randomly scattered revision would also extend to the net deduction cards which have to be written about February. When the new coding notices had already been issued before a change of residence had been determined—either because of the late receipt of the resident's return or a dispute—we should have to issue a fresh one.

6. We would be reluctant to contemplate such an inefficient arrangement with so many inevitable adjustments to work already done. It would be demoralising for staff, confusing for taxpayers, and put the timely issue of coding notices and deduction cards in jeopardy. The staff cost is estimated at 1,250 units: because the work could not be done over the year, however, but would have to be concentrated into less than half the year, the number of individuals needed would be upwards of twice this figure.

7. The alternative possibility would be to make a further separation from the PAYE cycle, so that not only would a separate residence return be needed, but also a separate residence coding would have to be sent to both employer and employee—in addition to the normal PAYE code. While this would avoid the need for large scale correction of PAYE codes, it would mean issuing an extra 20 million or so pieces of paper to employees, plus a further million at least (on the basis of a single list for each employer) to employers. There would also be much more prospect of error at the employer's end. At present employers get either a coded deduction card, or (for big employers) a list of names, but under the scheme

7. However, in our earlier note on employer's costs we pointed out (paragraphs 2 and 3) that one difficulty with combined tables was that, because of their bulk, they would be very inconvenient when income tax rates were changed in a Budget. This already entails a major printing job which has to be done on a very tight timetable; it is particularly important when tax rates go up to get the new tables into operation as soon as possible because the back tax from the beginning of the tax year to the date that the tables are brought into operation is collected in one sum when the new tables are first used, and the longer the delay in bringing the new tables into use, the greater the tax deduction in that week. With a flat rate LIT system it would in principle be possible to print combined tables in advance, covering the existing range of combined (LIT plus national) rates with some leeway at each end, so that a Budgetary or local authority change in rates would simply mean that a different one of the combined rates tables already held by the employer was used. With a percentage LIT combined rate tables would all be functions of the national table, so that a new national rate would mean reprinting all the LIT variables. This would hardly be practicable: so with such a scheme there would almost certainly have to be separate tables.

8. If one made the initial assumption that there would in any case have to be not combined tables, but separate LIT and national tables, then a percentage LIT would be somewhat more convenient. We would then produce a series of tables for each possible percentage rate showing the tax due, as obtained from the ordinary tax tables, and the actual tax to be deducted after the X per cent uplift. In other words, although two tables would be necessary, the second would give the tax deductible direct, and no addition would be required. These percentage uplift tables would have an indefinite life and the ordinary tax tables could be reprinted as now. (On the alternative flat rate basis, with tax charged at Xp in the pound, such an arrangement would only be feasible for cases where the tax due reflected only basic rate liability (and LIT therefore represented a fixed proportion of the tax due). In other cases it would be necessary to calculate LIT separately on taxable income, and deal with it as an addition to income tax.)

9. It was suggested that employers with mechanical and computerised payroll systems might find the percentage system easier to implement for PAYE deductions. We would expect any such difference to be generally fairly marginal. The difference would be between an LIT addition which was a percentage of national tax already calculated, and one which was an addition of a percentage of the taxable income figure which would have been produced earlier in the national tax calculation.

Inland Revenue

January 1976

Department of the Environment
Scottish Office
Welsh Office

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*to the Report of the Committee of Inquiry
under the Chairmanship of Frank Layfield Esq qc*

Local Income Tax: Evidence and Commissioned Work

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HER MAJESTY'S STATIONERY OFFICE

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COMMITTEE OF INQUIRY INTO LOCAL GOVERNMENT FINANCE

The Committee was set up by the Government in July 1974. The terms of reference were, "To review the whole system of local government finance in England, Scotland and Wales and to make recommendations".

The Committee's Report was formally submitted to the Secretary of State for the Environment, the Secretary of State for Scotland and the Secretary of State for Wales on 9 March 1976, and published on 19 May 1976 (Cmnd 6453).

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Foreword

1. This Appendix contains the principal written evidence submitted to the Committee on the subject of local income tax, together with the transcripts of oral evidence given on the subject by the Inland Revenue, HM Treasury, the Association of British Chambers of Commerce and the Confederation of British Industry. General views on local income tax are printed in Appendices 1, 2, 3 and 4.
2. The evidence by government departments represents the official views of the departments and not necessarily those of Ministers.
3. The Appendix also contains a report on visits made to Sweden, the USA and Canada on behalf of the Committee by representatives of Coopers and Lybrand Associates Ltd and the Committee's Director of Studies, Mr P T McIntosh, to investigate the operational aspects of local income tax in those countries.
4. The Committee received evidence from a large number of organisations and individuals. It also commissioned a number of studies. This Appendix is one of nine which are being printed to inform public debate and assist further study. The material in the first four appendices has been chosen to make available the general views put to the Committee by the principal government departments, the local authority associations and the political parties, together with a sample of the views of organisations representing various interests or sections of opinion. The other five appendices contain material from various sources that deal in more detail with individual topics studied by the Committee.
5. No document has been printed twice. The four general appendices therefore include some views on the topics which are the subject of the other five. Conversely the appendices dealing with individual subjects include particular aspects of evidence by government departments and other organisations.
6. A further selection of evidence and commissioned work thought to be of public interest will be published in microfiche form as Appendix 10.
7. The titles of Appendices 1 to 9, and the individual items in Appendix 10, are listed at page 295 of this Appendix.
8. It has only been practicable to publish a proportion of the evidence submitted to the Committee. However, all the main evidence is available for

inspection at the Public Record Office. Evidence relating particularly to Scotland and Wales is also available at the Scottish Record Office and the National Library of Wales, respectively.

9. The material included in the Appendices is printed as circulated to the Committee, save for editing to arrange it for publication. Some papers included have already been published or otherwise made available by their respective authors.

Evidence by the Inland Revenue

NEW SOURCES OF REVENUE: LOCAL DIRECT TAXATION

PREFACE

1. The memorandum is primarily concerned with administrative and technical feasibility but also has regard to the suitability of the taxes considered as new sources of local revenue and is designed to complement the note by HM Treasury on the general fiscal considerations. It also provides, in some detail, information about overseas local direct taxes, for which the Layfield Committee had asked.
2. The structure of the memorandum is as follows:
 - a. Ways in which direct taxes could be adapted to raise local authority revenue
 - i. Transfer or hypothecation of national taxes
 - ii. Charge at national level of variable local authority supplement
 - iii. Autonomous local taxation.
 - b. Criteria of suitability
 - i. Buoyancy
 - ii. Local fiscal responsibility and relations with central government (Grants and Policy)
 - iii. Confidentiality
 - iv. Yield and cost effectiveness
 - v. Implications for distribution, equity and demand.
 - c. Background considerations.
Changes in structure of local government and of the tax system.
 - d. Detailed study of forms of local income tax
 - i. Surcharge at national level, with variable or non-variable rates
 - ii. Locally administered and collected tax
 - iii. Application to business profits.
 - e. Other direct taxes as local sources of revenue.
 - f. Overseas experience.
3. The direct taxes considered as possible new sources of local revenue are the income and corporation taxes (including the charges on capital gains), the

capital taxes (capital transfer tax and the proposed wealth tax) and the stamp duties. The possibility considered at greatest length is that of a local income tax (LIT). The examination of this tax proceeds on the basis that LIT would be a refined tax of the kind we have nationally, and the criteria used are those appropriate to national taxes. If taxpayers were prepared to have imposed upon them a less refined form of income tax at the local level than at national level, then the assessment of the acceptability of LIT might have to be made from a rather different standpoint. This consideration is particularly relevant to the idea of a simple self-assessing type of tax. Subject to this, the memorandum identifies many difficulties, for some of which no easy solution can be seen and many constraints. None of the forms of LIT considered is thought acceptable.

4. Matched against the tests of suitability the LIT is questionable. Over much of the field it would do as well as the rating system but not much better. In some respects (confidentiality, incidence and distribution and impact on national tax policy, timing of payment) it would leave something to be desired. The central question is whether, given that little clear advantage appears to reside in relying upon a LIT as a successor or as a significant supplement to the rating system, the massive administrative effort and cost which would be necessary to bring the system into being and to maintain it would be justifiable. The memorandum expresses the view that it would not.

5. For the other direct taxes the choice between a centrally and a locally administered local tax does not exist. It would be theoretically possible to transfer or hypothecate corporation tax to local authorities but the problem of allocation of company profits would defeat this, apart from the importance of the tax as a national instrument of economic and monetary management. Capital gains tax, because of its fortuitous nature, would not be suitable as a local tax and the narrowness of the capital transfer tax base and the technical problems of charging the tax locally would make it unsuitable. While the ultimate form of the proposed wealth tax is still too uncertain to say definitely whether that tax could be a future source of local revenue, it seems an unlikely starter.

INTRODUCTION

1. This memorandum reviews the main possibilities for using the direct taxes as sources of revenue for local authorities. The direct taxes considered are the income and corporation taxes (including the charges on capital gains), the capital taxes (capital transfer tax and the proposed wealth tax) and the stamp duties. The memorandum is primarily concerned with administrative and technical feasibility. It also has regard to the suitability of the taxes considered as new sources of local revenue and is designed to complement the note by HM Treasury on the general fiscal considerations.

2. By way of background the memorandum first considers the various criteria of suitability for a local tax (paragraphs 6 to 15) and other background considerations (paragraphs 16 to 27). It then goes on to study in detail the possibility of a local income tax (LIT). We first take a preliminary look at some

general features of such a tax (paragraphs 28 to 31) and then consider an LIT charged as a surcharge at national level (paragraphs 32 to 45), either with a non-variable rate of tax (paragraphs 32 to 35) or with variable local tax rate (paragraphs 36 to 45). Then we consider, as an alternative, LIT as a locally administered and collected tax (paragraphs 46 to 49). Paragraphs 50 to 53 consider LIT as it might apply to business profits. Paragraphs 54 to 56 summarise the considerations relevant to LIT. In paragraphs 57 to 66 we consider the possibility of other direct taxes as local taxes; and conclude the memorandum with a discussion of overseas experience (paragraphs 67 to 78).

3. The memorandum considers at greatest length, amongst the possible local taxes, LIT, but it will come as no surprise to the Committee that none of the forms of LIT considered is thought wholly or indeed adequately acceptable. But this examination is conducted on the basis that LIT would be a refined tax of the kind we have nationally, reflecting finer shades of equity and ideas of social justice; hence the criteria used in assessing the tax are those appropriate to national taxes. But simplicity does not always go along with equity and if taxpayers were prepared to settle for a rougher and less sophisticated form of income tax at the local level than at national level, then the assessment of the acceptability of LIT might have to be made from a rather different standpoint. Any inequities produced by a simpler approach would be less of a burden on the taxpayers concerned because the rates of local tax would be lower and they might for this reason be less sensitive to divergencies from the national tax in the interests of simplicity. This consideration is particularly relevant to the idea that if any real way forward exists in the field of local income taxation it lies in the direction of a simple self-assessing type of tax. Subject to this general reservation, this memorandum identifies many difficulties, for some of which no easy solution can be seen and many constraints. Some of these arise out of the relation of the local income tax to the national income tax, others out of the staffing and other costs of the local income tax itself. Another important constraint is on the extent to which, even in the interests of simplicity, the national tax base could be adopted for local income tax purposes. It is difficult to see, for instance, how, outside an entirely autonomous LIT, local authorities could introduce allowances for children if these ceased to be available for national tax purposes as the result of the introduction of a scheme for child cash benefits as proposed by the Government. Difficulties of this and other kinds are examined in this memorandum with the primary aim of identifying and assessing the problems which will have to be solved if such a tax were introduced.

4. Unless the context otherwise indicates, the term 'local authorities' is used in this memorandum to cover both top-tier authorities (at the County level) and the second-tier authorities (at the District or Borough level). The memorandum does not, moreover, distinguish Scottish local authorities from others on the view that consideration of new sources of local revenue cannot in principle be confined to those other authorities. However, Scotland is a candidate for devolved taxation powers at the regional level and any such devolution may impinge upon the extent to which local authorities there could adopt a new revenue source. A similar issue arises in the case of Wales (see paragraph 20).

DIRECT TAXES AS LOCAL REVENUE SOURCES

5. There are three ways in which existing taxes can in principle be adapted as local revenue raisers:

- a. By transferring or hypothecating existing national taxes to local authorities. Thus the stamp duties could be converted into a local authority tax in the sense that the yield was allocated wholly to local authorities while the responsibility for administration and collection remained with the Board of Inland Revenue. Alternatively, a specified percentage of the yield of, say, income tax or corporation tax could be hypothecated to local authorities. In both cases the transferred or hypothecated revenue would have to be shared out among local authorities on some prescribed basis.
- b. By charging at national level a supplement on the national tax base for local authorities. This supplement could be charged either at a uniform rate and the yield distributed on some prescribed basis among them or it could be charged at varying rates according to the local authority to which the tax base was allocated. (The case for setting a ceiling on the locally variable rate is more fully considered in relation to LIT in paragraph 28f.)
- c. By duplicating existing national taxes at local level. The degree of duplication would depend upon the extent to which the local authority drew upon information which was available for national tax purposes. Relying upon such information could be a constraint if a major objective of local authorities was to be able to vary the local tax base in conformity with their own political policy objectives which might differ from those reflected in the national tax base. The more independent the local tax of the national tax, the more easy it would be to vary, for instance, its scope and distributional effects, but the greater would be the administrative costs and the technical difficulties of running the tax.

CRITERIA OF SUITABILITY

6. The crucial factor in assessing any local tax is whether it can be made to work satisfactorily. This covers a whole range of practical issues: the administrative costs of the tax; the difficulties of finding staff to operate it; the reaction of taxpayers and their agents; how employers would be affected. But whether any local tax can be made to work satisfactorily is not the only factor. In the following paragraphs we try to identify the general criteria of suitability which, taken together with technical and administrative feasibility, may determine the likelihood of any local tax ultimately becoming a supplement or successor to the present rating system.

Buoyancy

7. A common criticism of the rating system is that it lacks buoyancy, and in this respect rates are often compared unfavourably with income tax. The

'natural growth' of rates, between revaluations at any rate, is limited to that flowing from new and altered property, and it is therefore necessary to increase the rate poundage if, in a time of inflation, the yield of rates in real terms is to be maintained. In the case of income tax, by contrast, the operation of what is known as 'fiscal drag' means that if there are no changes in tax rates and allowances, increases in personal income, whether real or inflationary, will automatically bring about increases—in real terms—in the yield of income tax, without the need for any positive action by the tax authorities. While it is true that the buoyancy of income tax in this respect is greater than that of rates, however, the extent to which it would be possible for local authorities to exploit this buoyancy, supposing a local income tax to have been introduced, is questionable. So far as the tax threshold is concerned, the points at which tax now begins to be payable are not far removed from (and in some cases below) the supplementary benefit level, the official 'poverty line'. As for the rates of tax, the current basic rate of tax is 33 per cent, and there is also payable (from April 1975) an earnings-related national insurance contribution of 5½ per cent on the lower and medium ranges of employment income (up to £69 a week). Moreover, the yield of personal income tax as a percentage of total personal incomes has increased from 9½ per cent in 1950 to 15 per cent in 1974-75, and over the same period from 28 per cent to 48 per cent of central government taxation. The general question of the relativity between any local income tax and the national income tax is discussed more fully in paragraph 28f of the memorandum; but in the light of the foregoing figures, it seems clear that it would only be possible for local authorities to benefit significantly from the in-built buoyancy of income tax if national government, for its part, was prepared to rely on income tax buoyancy significantly less than it has done in the past, and possibly also to abate some of its existing claims on the yield of taxes on personal incomes.

Local Fiscal Responsibility

8. There are two divergent views about the impact which a local direct tax should make upon the community paying it. On the one hand it is suggested that the tax should have an almost imperceptible impact so that it is more readily paid. But, on the other hand, this implies that the community are less aware of the tax and therefore are less inclined to exercise the discipline on expenditure which would in principle be present with a more readily perceived tax; it is therefore said that with the more perceptible tax the sense of local responsibility for expenditure would be enhanced and priorities more consciously determined by the taxpaying community as a whole. Two considerations follow from these divergent views:

- a. If the perception of a tax is thought a valuable fiscal discipline, the tax should not only be felt by the taxpayer but clearly identified by him as relating to local authority expenditure. Thus a uniform local authority supplement on a national tax base might be less clearly identified as relating to local expenditure than an autonomous local tax of the kind referred to in paragraph 5c above. With the former, taxpayers would not be able to distinguish so clearly between the national tax burden and the local tax burden as they would with an autonomous local tax;

b. If any new tax is locally variable and locally identified with expenditure, it is important that it should not be exported in the sense that high rate areas could pass on their burden to taxpayers of other local authorities.

Relation of Local Direct Taxation to Grants etc from Central Government

9. There are two issues under this head. First, it is possible that any local direct tax would produce such a maldistribution of yield as between local authorities that it would add to the problem of equalising resources. This is a question which arises in principle on any of the direct taxes used as a local authority revenue source, but it is a significant problem only in relation to a tax capable of producing a high local yield so that, as a considerable supplement or indeed successor to the rating system, the resource distribution produced by it would be an important factor. On this basis it is likely to be a factor in relation to LIT and the question of distribution of yield is considered in paragraph 28e. The second issue relates to the interaction between the revenue derived from any new source and grants from central government. For some forms of local direct taxation there is a greater implication that there will be an effect on grant levels than for other forms (eg if the tax by its nature can only be a marginal source of revenue or because of the volatility of its yield, grants have to be 'cushioned'). There is moreover the difficulty that the interaction of grants and local direct taxation could produce a ratchet effect whereby, within the framework of the present system, expenditure notionally related to the new local direct tax of year 1 would become the expenditure in respect of which grants were sought and made in year 2.

Confidentiality

10. The confidentiality of tax information is a matter of great importance to taxpayers and affects their readiness to co-operate in making the system work. Of the forms of local taxes considered in paragraph 5 only that described in sub-paragraph a. (the transfer or hypothecation of existing national taxes) would not involve substantial changes in the present rules of tax confidentiality. For national tax purposes there is no longer any necessary connection between the taxpayer's home and his local tax office. Tax Offices deal with PAYE taxpayers generally on a place of employment basis and with the dispersal of a great deal of PAYE work from conurbations even this link is weaker than it used to be. But with a local tax confidential information about taxpayers would be held and used in the immediate community by officials with whom the taxpayer was in social contact. Taxpayers would resent information about their incomes becoming more widely known in the immediate community to which they belonged and there is a danger that they would become less reliant than at present upon the confidentiality of tax information and this could in turn reduce their compliance for national as well as local tax purposes. The need for confidentiality at local level would contrast strongly with the openness of the rating system and special provision would have to be made so that elected representatives could not have access to information about the tax affairs of individual local taxpayers.

Impact on Distribution and Incidence and Considerations of Equity

11. In assessing the suitability of a local direct tax the impact on the distribution of the burden within the community needs to be taken into account, difficult though it is to determine where burdens finally fall. The first factor is the extent to which the tax would shift the burden compared with its distribution under the rating system and the justification for any such shifting. It might, for instance, represent an entirely new burden for a sector at present derated—e.g. agriculture—or carrying less than the full rate burden—e.g. those enjoying rate rebates and it might be suggested that it would be necessary to have regard to the impact of any new local tax on individuals, not merely on them separately, but as groups sharing accommodation treated as one unit for rating purposes. Secondly, the local tax might create differences of burden where there is parity of treatment under the present rating system. This could happen, for instance, if non-corporate traders were charged to a new local tax but companies were not, thus disturbing the competitive balance between the corporate and non-corporate sectors. The total changes in incidence would also have to be considered from the point of view of equity. The national top marginal rates of income tax are already high (83 per cent for earned income and 98 per cent for other income) and these rates are payable at not immoderately high income levels. The addition of local authority rates of tax could raise effective and marginal rates to intolerably high levels.

Relation of Local Tax to National Tax Policy

12. The existence of an additional local tax on a direct tax base is likely to represent a constraint for central government in formulating policy in relation to that tax. The larger the local addition, the greater the constraint. On the assumption that the levels of taxation set by central government are to prevail, the margin for local government taxation is limited. Too small a yield, however, would bring into question the fundamental justification for the local tax, particularly as the costs of collection might be high. The latest estimate of the total rating receipts (the rate call) for 1974-75, for the United Kingdom as a whole, is of the order of £3,700m. and given the likely future growth in the fiscal gap between resources and needs it would seem questionable whether it was worth looking for a new source yielding less than some 10 per cent of this. If non-domestic rates continued in existence the figure would be reduced correspondingly: domestic rates amounted to some 33 per cent of the total yield (36 per cent before last year's exceptional domestic relief) and the minimum for a new source yield on this basis would be 10 per cent of £1,200m.—some £120m. However, whether a specific percentage is taken or some absolute amount as representing a minimum yield, the resultant figure is arbitrary. For 1975-76 the figures will rise sharply.

Payment of Local Tax and Certainty of Yield

13. The relation between liability arising and tax being paid on any direct source of revenue is an important factor in its suitability. The closer in time the two events, the more suitable the tax is likely to be; cash flow problems for local authorities would be less and the difficulties for taxpayers arising as a result of disparities between, e.g. income and tax due are likely to be reduced.

One of the chief characteristics of the present rating system is certainty of yield. The system has in some respects the character of a levy in that it divides a prescribed burden among the local community and it would therefore be advisable to look for a direct tax with a certain yield as a supplement to or substitute for rates.

Cost Effectiveness of Local Tax

14. The costs of administering and collecting any local tax would constitute the measure of its efficiency as a revenue source. If the cost per £ of revenue collected were significantly out of line with the national cost (for 1973-74 the cost was 1.71p in the £ for all direct taxes or 2p in the £ for rates alone) taxpayers could be expected to express concern and the spirit of compliance upon which the system – national or local – depended would suffer.

Demand Implications

15. The implications in terms of demand on national resources of any new local direct tax need to be considered. If a tax has a low or exceptionally uncertain demand effect, or an effect significantly out of line with that of rates, its suitability as a local authority revenue source is brought into question. Local authority expenditure generates a high demand level which is not wholly offset by the rates since these are likely to reduce private savings as well as expenditure. But if a tax which did not reduce demand to the same extent were substituted for rates an even greater imbalance could arise which would require a demand adjustment by central government so that the overall level of demand in the economy was regulated. An imbalance of this kind could arise if a tax such as the Capital Transfer Tax, which has a low demand effect, were transferred to local authorities as a substitute for a part of domestic rates.

EARLIER STUDIES

16. This memorandum relies heavily upon studies made in recent years concerning the financing of regional or local government. Foremost among these is the review of local direct taxation for the Commission on the Constitution, which was established in 1969 and reported in 1973 (Cmnd 5460). The Board were invited to submit evidence on the administrative and technical feasibility of transferring the taxes for which they were responsible wholly or partly to regional governments. The Board also submitted memoranda on specific matters raised by the Commission and on taxation changes subsequent to the original evidence. These memoranda are available in Part 10 of the Written Evidence. The Board also gave oral evidence to the Commission. In addition, in July 1971 a Green Paper on '*The Future Shape of Local Government Finance*' (Cmnd 4741) was published. In this the various possibilities for new local sources of revenue (including a local tax on income and profits) were summarised and discussed. The Committee will no doubt wish to consider these documents in full. For ease of reference, however, these and earlier examinations are summarised in Annex I.

17. The Commission on the Constitution accepted "the general conclusion of the Inland Revenue that there would be very substantial administrative and

technical difficulties in operating on a regional basis any of the duties now within their field". (Cmnd 5460, Appendix C, paragraph 6.) The Commission came to this view on the basis that it was not concerned with seeking new sources of revenue for local authorities as then known but with "the financing of Scotland and Wales and large regions of England. . . . Our conclusions should not be regarded as answering the question whether United Kingdom taxes could be devolved to local authorities". (Appendix C, paragraph 4.) This remark relates to the tax which the Commission saw as a possibility for devolution. They suggested that "any regional tax on total income should take the form of a supplement to United Kingdom income tax and be centrally administered" (paragraph 26). But they saw their suggestion as relevant only to the large regions of the Redcliffe-Maud type (see paragraph 19) and not to lower-tier or significantly smaller authorities.

18. Although there have been changes in the structure of local government and in taxation since the Board's evidence to the Commission on the Constitution and since the 1971 Green Paper, most of the considerations and difficulties identified in those documents remain. The present memorandum does not set out to repeat the contents of earlier studies but to build on their foundations. As the next step it identifies changes which have occurred in the structure of local government and in taxation, which have to be evaluated against this earlier evidence, and it tries to bring together in a shorter form the problems which would have to be resolved if a local tax were to be a feasible source of local revenue and an assessment of its suitability in relation to the criteria identified in paragraphs 6 to 15 above.

CHANGES IN THE STRUCTURE OF LOCAL GOVERNMENT

19. The changes in the structure of local government in England and Wales and, as from May 1975 in Scotland, have important implications for local direct taxation. The Redcliff-Maud Commission recommended that England should be reorganised into 3 metropolitan areas and 58 other new local government areas grouped in 8 provinces (this leaves the GLC out of account). In the event local government reorganisation has taken a somewhat different form: in England there are 6 metropolitan counties divided into 35 districts and 39 urban and rural counties organised into 296 districts or boroughs, with the GLC and the 32 London boroughs organised separately. Wales has 8 counties organised into 37 districts or boroughs. As from May 1975 Scotland will have 9 regions and 3 Island authorities and 53 districts. This means that including Scotland there will eventually be 66 top-tier authorities and 454 second-tier authorities in Great Britain. In general the latter are the rating authorities. Compared with the prospect of some 11 large regions contemplated by the Commission on the Constitution, the great enlargement of the possible scope for local variation of rates and forms of tax must inevitably make devolution below the national level more difficult. The extent to which such variation was possible would depend upon the setting of a national limitation on the local charge. The existence, for instance, of a 5p limit to a local income tax could have the effect of limiting the number of rates to 10 (assuming that steps smaller than ½p would not be acceptable).

20. In connection with the local authorities in Scotland and Wales the Committee will wish to be aware of the examination which is at present under way of means by which within a framework of democratic accountability powers could be devolved to Scotland and Wales. These ideas are discussed in the White Paper '*Democracy and Devolution - Proposals for Scotland and Wales*' (Cmnd 5732) presented in September 1974. The White Paper speaks in paragraph 31(c) of "the desirability of some uniformity of standards of services and of contributions in all parts of the United Kingdom". This may not however be taken as implying that the possibility of marginal taxing powers for Scotland and Wales has been ruled out by government decision. It is, therefore, not beyond possibility that the same direct tax might be advocated as the new source for both regional and local taxation when it might in fact be a question of it serving as a source for either one or the other, but not for both.

CHANGES IN THE TAX SYSTEM

21. There have also been a number of changes in the tax system. The impact of the unification of income tax and surtax was taken into account in Memorandum C submitted by the Board to the Commission on the Constitution ('*Modifications to Earlier Evidence - 1971 Budget Proposals*''). This memorandum made it clear that unification left largely unaffected earlier consideration of the feasibility of a provincial income tax. It was also noted that the question of a provincial surtax in the form discussed in the original memorandum to the Commission no longer arose, as surtax had ceased to exist as a separate charge.

The Tax Credit Scheme

22. Although the present Government has not taken a decision against a negative income tax, the introduction of a tax credit scheme on the lines proposed in the Green Paper (Cmnd 5116) presented by the previous Government is not in contemplation. The Board would, therefore, suggest that ideas for local income taxation should be examined on the assumption that the present income tax system at national level will not be superseded by some form of tax credit scheme. Some representations made to the Committee have tried to integrate the rating system into a tax credit scheme (the representations from the Association of District Councils are to this effect) but ideas of this kind fall if a tax credit scheme is not introduced by central government as the main means of income redistribution.

Corporation Tax

23. The corporation tax system was substantially changed in 1973. Under the pre-1973 system (known as the classical system) the taxation of company profits was separate from the taxation of shareholders and the tax paid by the company on its profits was distinct from the tax which the company had to deduct and account for on dividends it distributed to its shareholders. Under the new corporation tax system (known as the imputation system) part of the company tax is imputed in the form of a tax credit to the shareholder and satisfies his

basic rate income tax liability. Because the corporation tax has to cover the tax credit on the dividends it follows that the rate is higher than under the previous system, at present 52 per cent compared with the rate of 40 per cent in the last year of the old system. Under the new system certain small companies are charged to corporation tax at a lower rate – at present 42 per cent. The estimated yield for 1974-75 (after allowing for the stock relief proposed in the Autumn Budget) is £2,735m.

24. The change from a classical to an imputation system makes no easier the solution to the fundamental difficulty (as expressed in the report of the Commission on the Constitution) that “there is no satisfactory way of allocating to individual regions the profits of the many companies which operate in more than one region, often on a nationwide basis” (Report, Appendix C, para. 27). Nor would it make any easier the deduction at source of local authority tax whether at a common rate or varied according to local authority. Under the imputation system there is no separate shareholder withholding tax which companies have to deduct and account for. There is, therefore, no simple variation possible by which local authority liability could be accounted for at source.

New Taxes on Capital

25. A number of new taxes are being introduced. Estate duty is being replaced by capital transfer tax. Under this tax not only death will be an occasion of charge but so also will be the transfer of assets during life. The capital transfer tax will not finally supersede estate duty for some years and for the first year or two the yield may be below the levels which estate duty would have produced; but over time it is likely to build up to levels in excess of estate duty. The last estate duty estimate (for 1974-75) was a yield of £380m. It is also proposed to introduce a wealth tax. This tax would fall on individuals (and trusts) but not companies; the rate at which it is to be charged has not yet been decided nor have many of the details of how it is to apply and of what reliefs will be given. A Select Committee has been set up to consider the Green Paper on Wealth Tax (Cmnd. 5704). The yield will depend upon the rates of tax charged: in the Green Paper two illustrative rates of tax are given and the yields for these are (in terms of 1972 values) between £200m. and £275m. for the more moderate tax and between £350m. and £425m. for the more steeply graduated tax.

Development Gains

26. New charges have been levied on development gains from land and it is proposed to introduce a development land tax. It is intended that eventually the latter tax will consume most of the former charges on development gains and it would therefore serve little purpose to consider the development gains charges as sources of local revenue. The development land tax itself will be a transitional charge from which local authorities will be exempt when they purchase land. In due course they will be able to buy all development land at current use value. Both in the transitional scheme and in the final scheme local authorities will be deriving benefits in that their expenditure will be decreased

when they buy land. They will also eventually derive profits from their transactions in land but these too will only be applied to capital transactions and both the incidence of the benefits throughout the country and their timing are uncertain. Moreover the government will itself be entitled to a major share of these profits. For all these reasons the scheme is not likely to provide significant local income to all authorities in the immediate future.

AUTOMATION AND ORGANISATIONAL CHANGES

27. The Board reported to the Commission on the Constitution (Memorandum C) that the Department's computer programme had been suspended and was under review. This review covered the possibility of introducing simpler forms of PAYE and took account of the organisation and automation changes which would be necessary if a tax credit scheme were to be introduced. But, as has already been mentioned, it is not the present intention to proceed towards a tax credit scheme. There have not been any significant automation or organisational developments which are relevant or would be helpful to local taxation.

A LOCAL TAX ON INCOME AND PROFITS

28. It is frequently suggested that a local income tax should be introduced as a new source of local revenue. Before considering such a tax in detail there are a number of preliminary matters for consideration:

a. Form of Tax

A local tax on income (LIT) could in principle take any of the forms described in paragraphs 5a to c above.

b. Types of Income and Persons Chargeable

The possibilities range from charging the total incomes of all persons to charging only an element in the total incomes of a particular category of persons. Thus, at one extremity, the charge could be on the entire income (including that from overseas sources subject to overseas tax of every person – individuals and companies, and including trusts); at the other extreme it could be a charge limited to one kind of income (e.g. income subject to PAYE or income derived from capital) of individuals only. The more selective a tax is, either as regards income charged or the category of taxpayer liable to the tax, the more likely it is that questions of equity and the distributional impact of the charge in comparison with rates would arise.

c. Levels of Local Taxation Jurisdiction

Attention has already been drawn to the effects of the reform of local government in England and Wales and the imminent changes in Scotland on the levels at which local taxing jurisdiction might be exercised (see paragraph 19). Over the past ten years a two-tier system of local government has been established (the new Scottish authorities will not take over till May of this year).

The first tier is represented by the metropolitan, urban and rural counties and the second by the borough and district councils and revenue raising rests with the second tier authorities. (The third tier of local government – the parish councils in England and the community councils in Wales and Scotland may be left out of account in this context). Control of expenditure is generally allocated to the first or second tier according to the nature of the service. From the point of view of LIT the question is whether taxing jurisdiction will rest with the first or second tier authorities. If direct taxing powers have to be devolved below national level, and as a matter of feasibility those powers are given to the top tier of local government, there could be a closer identity between the authority raising the revenue and the authority spending it than there is under the present rating system. This would be the case if domestic rates remained as a second tier charge. Taxpayers would then pay LIT to the top tier authority and rates to the second tier thus achieving an apparently closer identity between taxation and expenditure than exists under the present system.

d. Allocation of Taxing Rights

A fundamental problem for any LIT is the basis on which income or profits should be charged: the choice is between a residence basis under which the local authority in which the taxpayer has his principal residence has the sole taxing right on income wherever arising and the so-called source basis under which the local authority in whose area the income arises has that right. Where neither authority has sole taxing right but there is taxation both on a residence and on a source basis problems of double taxation would inevitably arise. It is not always easy to determine either a taxpayer's residence or the source of his income. For instance the residence status of taxpayers with more than one home or who travel about in their work, use lodgings or caravans may be difficult to determine. Difficulties would also arise where the taxpayer moves house frequently during the course of the year. Although it might be suggested that the Electoral Register should be used to determine residence, this inevitably cannot be completely up to date and could turn out to have no greater validity than other factual evidence. The source principle may also be difficult to operate. Even for employees (in some respects the easiest case) the source of income could not ultimately be settled by reference to the location of the employer or even by reference to the particular plant in which the employee worked or with which he was connected (e.g. because it was his pay point). In the case of a commercial salesman, at least the selling 'profit' would be earned at the point of sale. The residence and source principles are not necessarily mutually exclusive; as explained above double taxation could arise and complicated agreements would be necessary under which the authority of residence and the authority of source share out the tax on the income between them. Problems of this kind arise, for instance, for the Swiss Cantons. It is, however, now generally accepted that the residence principle prevails over the source principle and as there is in the context of local government taxation a relation between the taxpayer's residence and the benefits he enjoys which does not exist between the source of income and the benefits, the examination which follows of local income tax is based on the assumption that it will rely upon the residence of the taxpayer to establish which local authority is entitled to charge him.

e. Yield of LIT

The Tables in Annex II are designed:

- (i) to enable a comparison to be made between domestic rate capacity in relation to pre local government reform counties. It will be noted from the Tables in Annex II(A) that there is a fairly high correlation between the two. Even where there are changes in order between the two, the moves are generally at most a place or two (Sussex is the exception - ranking 9th for total net income and 4th in terms of domestic rateable value);
- (ii) to show in Annex II(B) average income tax rates for the United Kingdom as a whole and for England, Scotland, Wales and Northern Ireland separately and by county (pre local government reform) for England only, on the basis of 1971-72 income distribution (the latest year for which the information is available). These figures should be regarded with some reservation; those for the county income distribution may be subject to sampling weaknesses. Also shown are the yields of domestic rates and the domestic rate burden is expressed as an addition to both the *average* rate of income tax and the *standard* rate (the standard rate of income tax was the predecessor of basic rate income tax). Thus at one extreme the increase in the average rate for LIT would be 1.87 per cent for Nottinghamshire and Herefordshire and at the other 3.75 per cent for Sussex. It may be thought that variations of this size would be as perceptible as present rate poundage variations and no less questionable but the magnitude of the additional burden becomes even more sharply visible when expressed in terms of additions to the standard rate of tax (which for the majority of taxpayers represented the marginal rate¹). The addition for Herefordshire would be 4p, for Nottinghamshire 5.22p and for Sussex 8.05p. Durham, with the lowest average rate of personal tax to begin with, faces the second highest addition to the standard rate of income tax at 8.57p (the highest would be Lincolnshire at 8.89p). The Tables also show the yield of 1p rate of LIT for each country and English county as a measure of resource disparity. At the upper end of the range, the GLC would receive £31.3m. on a 1p LIT; at the bottom end Westmorland would receive £2m. These figures, however, cannot be taken as applicable now. They do not reflect changes in the distribution of rates receipts, personal incomes and taxation between 1971-72 and the present time. Nor do they throw light on what the total target yield for LIT should be. The possibilities (and they are fairly arbitrary) are:
 - (aa) as a supplement to rates: the figure of £120m. would be the minimum if domestic rates only were in question, or £370m. if both domestic and non-domestic rates were involved (see paragraph 12);
 - (bb) as a replacement for rates: the target yield would be a minimum of £3,700m. (£1,300m. for net domestic rates only); and

¹ Before earned income relief.

(cc) as a replacement for rates and to replace some of the funds at present derived from grants: a yield of £4,000m. would be a minimum (say £1,500m. for domestic rates only).

The above estimates do not reflect the need to secure greater revenue to close any fiscal gap which may emerge. There is a presumption of the buoyancy of LIT but for the reasons given in paragraph 7 this may not be anything like substantial enough to close the gap. Even on the figures quoted above (*a fortiori* on the higher figures necessary to close the gap) a contribution from LIT of £3,700m. (paragraph (bb) above) or at the maximum £4,000m. (paragraph (cc) above) must bring into question the total impact of the tax; these amounts imply LIT rates of 12.3p or 13.3p in aggregate, which would be in addition to the national rate. The remarks made in paragraphs 11 and 12 are relevant and bring seriously into question the suitability of a LIT as a major source of local revenue.

f. Extent of Discretion in Charging LIT

(i) The preceding paragraph raises the issue of the relationship between national and local tax burdens. Only by clearly specifying the relation of LIT to the national tax can the danger of competitive friction between the national and local tax authorities be avoided. We take it as our starting point that the national tax must have priority over the LIT. This does not mean that the national rates of tax would be set without regard to the needs of LIT. Indeed it might be suggested that as rates of LIT would affect levels of grant the amount of tax needed to be raised at the national level would be diminished in some relation to the amount of tax being raised locally. But no such simple relation as this is likely to exist and the possibility cannot therefore be ruled out of a conflict of resources between national and local authorities. Should any such conflict arise the national charge must have precedence and must not be pre-empted by LIT. This is essential if the capacity for central economic management is to be retained. The existence of high national top marginal rates of tax (83 per cent for earned income and 98 per cent for other income) in principle constrains the rates of LIT and while it does not necessarily follow that LIT rates could not exceed 2 per cent, some means would have to be devised of regulating the total tax burden.

(ii) The obvious way of confining LIT would be to specify a ceiling rate. Local authorities might all charge the maximum rate in response to such a limitation but at least the possibility of local variation would be provided without sacrificing the essential managerial role of central government. But a simple rate ceiling would not prevent local authorities from seeking an incidence for their tax which differed from that for national tax. Thus local authorities might seek to shift the burden either upwards or downwards by manipulating rate bands and rates within the permitted ceiling. If the tax were locally autonomous there would be the further possibility of altering the tax base as well as the incidence (e.g. by altering the relationships between the main personal allowances or giving new allowances or reliefs for home to office travelling or the like). Variations designed

to alter the incidence of a centrally collected surcharge type of LIT would add very considerably to the serious administrative and technical difficulties of running the tax and would raise political issues related to the extent to which autonomy in matters of taxation is to be given to local authorities.

(iii) Variations in the tax base raise issues of even greater difficulty. Departures from the national tax incidence and base would mark the separateness of the local tax and this might be desirable in the interests of fiscal responsibility, but it would represent a step beyond giving local authorities a new source of finance. They would also have in their command a means of redistributing income on a different basis to that offered by the national tax. This might be a step which neither national nor local government would wish to see taken. On this view it would be desirable to secure that for any LIT the national incidence and tax base would have to be applied without variation. The difficulties of justifying such an invariable rule are, however, illustrated by allowances for children. The Government have announced their intention of introducing a child benefit scheme which will amalgamate family allowances and child tax allowances into a new cash payment made to the mother. When, as the result of this scheme, income tax child allowances cease to exist at the national level, local authorities might well find themselves under heavy pressure that allowances for children should be reinstated for LIT purposes, for without them there would be no difference in burden between married couples with and without children. But this in turn would require child cases to be specially identified for LIT when this was no longer necessary for national tax purposes and a very large wedge would have been driven between the national tax base and the LIT base.

g. Total Income and Deduction of Tax at Source

In general the national tax system has regard to total income (eg in determining the rate to be applied to the income of an individual) but it does not always require total income to be assessed. It avoids assessment by relying upon deduction at source. Thus, in any system of LIT dependent upon the national taxes the following issues are likely to be relevant and may be decisive:

- (i) ideally LIT should be collected alongside and at the same time as the national tax;
- (ii) if this is not possible then there are two possibilities. Either a separate deduction at source system can be applied for LIT purposes, or the LIT liability can be determined by end year assessment of total income. The extension of deduction at source could have considerable cash flow advantages for local authorities over end year assessments of total income. It would on the other hand give rise to very difficult problems for payers. It may be the case that, for instance, the payer of interest or dividends does not know the beneficial owner at the time of payment. He would not therefore know the rate of LIT to apply (if it were variable) or whether the income was not in fact chargeable to LIT (belonging, e.g. to a non-resident or a gross fund).

If end year assessments have to be used there are two immediate theoretical difficulties (apart from the practical problems of getting the great mass of additional work done). The first relates to the delay in collecting tax from current liabilities which could be expensive – initially, and possibly in the long term – for local authorities and the second relates to the difficulties of collection which would arise due to the volatility of personal income tax (tax due on high level of income might fall to be collected in a low level of income year).

29. In this and the following paragraphs we consider the particular difficulties arising on the various forms of LIT as they have been analysed in paragraphs 5a to c above. Of these the first requires briefest mention. It is beyond contemplation that the national income tax could be transferred to become a local authority tax. The latest 1974-75 yield estimate for income tax is £10,500m.; it contributes over 73 per cent of the yield of Inland Revenue taxes and 48 per cent of total taxation. The revenue yield is too large to permit wholesale transfer. The income tax must remain one of the main instruments for central economic demand and monetary management. Nor would the hypothecation of a specified percentage of the yield be a particularly satisfactory source of revenue for local authorities. How it was allocated would be for consideration: it could be by reference, for instance, to income by area (not below county level however) or by need or on full RSG basis. But it would not amount to more than a book-keeping transaction between national and local government and as well as having none of the virtues of a real LIT, a hypothecation system would not necessarily be as satisfactory for resource allocation as a grant system would be and might merely serve to reduce any grant below the level which would have been paid had a hypothecation system not been in operation.

30. Reference has already been made in paragraph 28f to the acute problems which might arise if the national tax base became an imperfect base for LIT (the case quoted related to the removal of any allowance for children at national level). In this situation the problems of using the national tax base for either of the forms of tax considered below would be exacerbated and the need to adjust the computations to determine the LIT payable would arise in many more cases than are contemplated in the paragraphs analysing these forms of LIT.

The National Income Tax System

31. As a basis for the analysis which follows of the various forms of LIT, the Committee may find it useful to have a brief description of the income tax system. Because of its schedular origins the system has laid less stress upon total income than is the case with other developed countries. Total income has become a more important element since the unification of income tax and surtax in 1973 but it remains the case that where liability can be met at source, no further action is necessary. Applying this principle to the various kinds of income, the position is as follows:

- a. PAYE is the prime means of collecting the income tax due from wage and salary earners. It is a sophisticated cumulative (ie self-adjusting) system under which the amount of tax collected throughout the year represents in the great majority of cases the final liability without further adjustment. For 1972-73 it is estimated that approximately

84 per cent of all personal income tax was collected through PAYE and in approximately 85 per cent of cases no further action was required by Tax Offices after the end of the year. The PAYE system depends upon two important components: first, the code number which the Tax Office determines for each taxpayer on the basis of information held about his personal circumstances, covering the allowances that are due to him for, e.g. himself, children and other dependants, and for other matters such as building society interest and life insurance premiums; and second, the tax tables operated by employers which determine the amount of tax deducted from pay cumulatively, week by week or month by month. It will be seen that there is a great deal of difference between a system of this kind, which sets out to collect currently the appropriate amount of tax and other less sophisticated forms of pay-as-you-go taxation, under which only an approximate amount of tax is currently collected, the final bill being settled at the end of the year. The United Kingdom system permits some economy of effort: the great majority of taxpayers are only called upon to fill in an income tax return once every three years and, generally speaking, the code number originally issued prior to the commencement of the year does not have to be changed during the course of the year.

- b. The PAYE system can also be used to collect tax on income other than earnings, e.g. on interest received gross. This is done by reducing the personal allowances to which the taxpayer is entitled so that an additional amount of tax is recovered under PAYE to meet the expected liability arising on the other income. Where liability cannot be recovered in this way or where there is no PAYE source at all the income may have to be separately assessed. In many cases however the liability is met by deduction at source at the basic rate and the question of further assessment only arises if the taxpayer's total income is such that higher rate tax is payable. In the case of dividends under the imputation system of corporation tax the payment of advance corporation tax by the company secures a tax credit attached to the dividends which satisfies the basic rate tax liability.
- c. The third category of income consists of profits from a trade, business or profession. Tax on such income has to be recovered by direct assessment on the taxpayer who makes payments under assessment to the Collector of Taxes.

It is essential to the discussion that follows that the national income tax system should keep to the minimum the number of cases in which the total income of the taxpayer has to be formally calculated and assessed, but that it does this without excluding incidental or subordinate income from assessment. In this way, however imperfectly, it seeks to combine economy with equity.

Non-Variable Rate of Tax

32. In its simpler forms this tax would consist of a standard surcharge for local authorities on the national income tax base. It would have much in common with hypothecation except that the administrative costs would be significantly greater. Local authorities would be entitled to a percentage of taxable income,

that percentage having been determined nationally and applied uniformly throughout the country. The effect for the taxpayer would be the same as an increase in the basic rate of tax. The administrative problems revolve primarily around the allocation of the tax so collected to the appropriate local authority and the determination of total income.

33. We look first at the PAYE position. It would be unacceptable for the local tax collected by a particular Collection Office to be attributed to the area in which the Collection Office was situated. A Collection Office receives tax collected on behalf of employees and from other taxpayers who may or may not have the same connection with the area in which the Collection Office is situated. Any links that happen to exist are likely to become even more tenuous in the future as it is envisaged that within a few years collection work will be centralised in three automated accounts offices. It would be equally unacceptable to allocate the tax by reference to the taxpayer's Tax Office as the Tax Office dealing with the employee's tax affairs would generally be that related to the place of his employment rather than his home address. Moreover, as a result of schemes for dispersing work from London and for concentrating work in the regions this traditional link has now often disappeared too and the PAYE tax affairs of many employees are now dealt with by Tax Offices far removed from both the taxpayer's home and his place of work. Thus if the local income tax took the form of an addition of, say, 2p in the £ to the national income tax, and arrangements were made for employers to deduct and account for the additional tax, the problem of dividing it up amongst the local authorities of those areas in which the employees lived would represent an entirely new and considerable task. It would be difficult to leave this to employers. The task of determining an employee's residence for the purpose of the local tax might not be straightforward (as is explained in paragraph 28d above) and it has some of the quality of an administrative judicial act. Employers would resent having a task such as this put upon them. Even if they were able to determine residence and keep an accurate record of all changes, the clerical and computer burden of sharing out the tax among the local authorities involved would be enormous.

34. Thus it seems inevitable that the task of determining residence and sharing out the tax would fall upon Tax and Collection offices unless some means could be devised of devolving to employers work that would be within their capacities. As yet we have not been able to find any compromise solution of this kind. Proceeding therefore on the assumption that the task would fall to Revenue offices, even if changes of residence during the year were ignored, it would involve a new annual operation of obtaining from each taxpayer a statement giving all the factors relevant to the determination of his place of residence at the beginning of the tax year and then determining his residence position. Existing records could not be used because returns only show a postal address at the time the return is completed and many taxpayers do not receive returns every year. Once residence was determined the tax office would have to notify the Collector so that the appropriate amount of tax remitted by the employer could be passed on to the local authority concerned. This notification would itself be a considerable task. It would have to be done every year since if a person stayed in the same job he might have changed his

residence; and for many people more than one notification would be needed because of changes of job during the year—there are about eleven million job changes within PAYE annually—or because the employee had a second job. Even with a fixed rate of tax the Collector could not readily determine the amount of local income tax deducted unless it was separately recorded on end of year documents by employers. Inevitably there would be cases where the local authority tax could not be allocated to any local authority because, for instance, the employee's tax records had not been linked with the income of that employment or he had not completed his residence return. Moreover, the Collector could only begin to pay over the local tax he received from employers after the end of the tax year as he does not receive particulars of amounts of tax applicable to each employee until then. For employers to give details with each monthly remittance and for the Collector to seek to allocate the local tax and pay it over to the local authorities each month, would impose a very heavy burden on employers and the Revenue and would represent a major change in the present PAYE system.

35. Thus, on examination, even the simplest form of a centrally administered tax raises substantial administrative problems which could not be overcome without changes which would add significantly to the complexity and operational costs of PAYE. Moreover, the paragraphs above deal only with the allocation of tax collected by deduction from wages and salaries during the year. In many cases there are overpayments or underpayments which need adjusting after the end of the tax year, sometimes up to several years later. To follow through all these adjustments for local tax purposes would entail greatly increasing the complexity of the present system. This point is discussed more fully in the following paragraphs in relation to a local authority tax with variable rates.

Variable Local Tax Rates

36. The administrative difficulties outlined above would be increased if different local rates of tax were charged according to the local authority of residence. The following paragraphs touch on some of the problems involved for the Revenue. But it should be remembered that employers would have correspondingly increased difficulties with their pay-roll operations, especially those in business on a nationwide basis who use centralised pay systems. The efficient operation of PAYE rests to a large extent on the wholehearted co-operation of employers and is already an expensive operation for them. We cannot emphasise too strongly that there is a limit to the willingness and ability of employers to operate a significantly more complex system than exists at present. Our experience is that many of the smaller employers already find difficulty in understanding and operating the system as it stands. Concern for the administrative burden on employers was one of the main factors in the evidence given by the CBI to the Select Committee on the Tax Credit Scheme and there is no doubt that it would be as significant a factor here. The burden on employers increased with VAT and will grow even further with the work on earnings related national insurance.

37. Residence which (for the taxpayer) would be more or less an academic matter with the uniform local authority rate of tax would, with rates of tax

varying from one authority to another, become a matter of greater importance to the taxpayer and hence dispute. For the reasons given it is not to be assumed that the determination of residence would be a particularly easy task. The Tax Office would have to obtain the necessary information to determine residence and notify the taxpayer who would have a right of appeal. The tax rate would then be notified to the employer and the Collector informed of the local authority to which the local tax should go.

38. Operational problems of the employer would be considerably increased by the existence of a number of different rates of local tax. Although it is likely that the rates charged would have to fall within a limited band (for the reasons given in paragraph 28f) there would be scope for variation especially if the right to levy tax was extended to second tier authorities. Employers would have to calculate the local authority tax separately by means of separate tables and then record and account for it separately. This will clearly add very substantially both to employers' work and the scope for errors which would have to be corrected by the Tax Office after the end of the year.

39. Tax would often have to be deducted from wages before the appropriate local authority rate had been determined, for instance, if there was an unsettled appeal about the place of residence, or someone was taking up work for the first time. At present, where an employer does not have a PAYE code for an employee an emergency code is used which ensures that in most cases a substantial amount of tax is deducted (which will, of course, be adjusted on the cumulative basis when the appropriate code number is issued). It would be a relatively simple matter to arrange for local authority tax to be deducted under any emergency code set by reference to the maximum local authority rate, but this would bring its own problems. With a taxpayer with more than one source of untaxed income, and who paid tax by reference to the emergency rate, it would be possible for there to be an overpayment of local tax and an underpayment of national tax. There will also be cases where, for various reasons, it was found that at the end of the year local tax had been under-deducted. In principle it would thus be necessary for there to be a provision for local and national tax to be calculated and dealt with separately when assessments were made and issued after the end of the tax year, and for separately repaying overpayments and collecting underpayments. There would inevitably be more assessments; some would be due solely to the local authority tax deductions not being right and many more would be complicated because of the need to consider national and local tax separately (these would be additional to assessments arising as a result of an extension of end of year assessing to collect authority tax on total income—see paragraph 43 below).

40. It might be suggested that dealing with end of year overpayments and underpayments of local tax was a refinement which could be ignored, though this would be particularly difficult to justify in relation to overpayments. There would, however, still be important repercussions on the work at present carried on by Tax Offices. It would, for instance, be difficult to continue the present system whereby most underpayments of tax for those in employment are collected through a coding adjustment for a later year because this would then automatically result in too much local authority tax being paid in the year in

which the adjustment took effect. Even if underpayments of local authority tax were collected, it would be awkward to continue to use this system because the local authority to which the underpayment was allocated would not be the correct authority if the employee moved his residence before the adjustment took effect; and if the tax rate of his new authority was different, the amount collected would be wrong also. Alternative means of collecting underpayments are much more expensive than 'coding-in'. This was a substantial problem with the tax credit scheme in which the coding-in facility would have been lost.

41. This discussion brings out the important point that it is inappropriate to consider the PAYE system in isolation. It is not a tax system in itself, but merely a means of collecting on a provisional basis tax on account of liabilities under Schedule E (remuneration from offices and employments). There are many reasons why, during the year, the right amount of tax is not collected by deduction at source, and in these cases the necessary adjustments have to be made after the end of the tax year. Any proposal for collecting local tax at a variable rate through PAYE must also make provision for all these end of year matters. As the previous paragraphs show, this leads to further complications and administrative problems.

Non-PAYE Income

42. The discussion so far has been principally related to PAYE income and does not take account of the complications which would arise where there is income from other sources, e.g. from a trade or business or investment income. We shall be considering trade and business income under the general heading of "Business Profits" in paragraphs 50 to 53 below. It is, however, relevant in this context to bear in mind that there are many employees within the PAYE system who have trade or business income as well, which would also have to be brought into charge to LIT possibly on a different basis from that adopted for other income (the residence principle is not so sustainable as the exclusive principle of charge in the case of business or trade profits). If the source principle prevailed for trade or business income over the residence principle such income would have to be separately charged and accounted for and it would no longer be the case, even in the PAYE field, that for each taxpayer there was one local authority to which his tax was due. As regards investment income a system of deduction at source could not be introduced for all the various sources. Even with a uniform rate of local authority tax it would not be possible for companies for example to be made responsible for deducting at source the local tax liability of shareholders or for banks to be made responsible for liability in the case of interest. As was pointed out in paragraph 28g, the recipients of such income would not invariably be the beneficial owners. If rates of tax were subject to local variation the problem would be even more unmanageable.

43. The only solution, therefore, appears to be a system of end-year assessment of total income. This means that LIT must be at least as perceptible a tax as rates because the taxpayer will be able to identify his LIT just as he knows his rates bill. End-year assessment would require a great deal of new information as well as the unscrambling and reprocessing of information already held. In the great majority of cases (taxpayers not liable at rates above the basic) it is

not necessary to compute total income exactly and Tax Offices do not necessarily have information about total income to hand. This does not mean that the income of such taxpayers escapes tax; tax may be deducted at source and in the case of income in the form of ordinary dividends from United Kingdom companies the tax credit secured by the payment of advance corporation tax means that the basic rate liability on the dividends is met. To introduce a system under which a separate charge to local authority tax at variable rates had to be made on all income would represent another large administrative burden. Even where the charge could be added to an existing assessment, e.g. an assessment on business profits, it would be in effect another assessment at a different rate, the tax on which would have to be accounted for separately. In other cases, for example, dividend income not liable to higher rate tax or investment income surcharge, an assessment would be needed solely to levy the local authority tax.

44. It has been suggested that a way round these difficulties might be to charge only PAYE income to local tax. But this would be seen to be manifestly unfair in principle as it would represent a redistribution of the local rate burden on to one particular section of the community. Moreover, as explained above, no real distinction could be made between income taxed under PAYE and other income, because the PAYE system is not a substantive tax of itself. It is already necessary to make annual assessments on a significant number of people within the PAYE system where the tax deducted does not match the actual liability, and for the reasons already given this would increase if a variable rate of local tax was also collected through PAYE.

45. The administrative problems created by a centrally administered local tax system incorporating supplements determined by local authority rates of charge, were described in paragraphs 22 to 34 of the Inland Revenue Memorandum A to the Commission on the Constitution. These remain applicable *mutatis mutandis*. Two points are however worth mentioning. First, these paragraphs were written against the background of proposals for up to 11 provinces, each possibly with its own rates of tax. If local authorities have the power to levy different rates of tax, the number of rates of tax in operation (subject to the effect of any ceiling on LIT – see paragraph 28f) and the number of occasions when a taxpayer moves from the jurisdiction of one local authority to another would be greatly increased. A similar scheme for local authorities would thus be operationally far more complicated. Second, the unification of income tax and surtax means that Tax Offices now calculate taxpayers' total income more often than before, and for those whose total income is assessed to income tax there would, in principle, be less difficulty in levying a local authority charge even with varying rates. This is, however, a relatively minor change affecting only those liable to higher rates of tax.

LIT AS A LOCALLY ADMINISTERED AND COLLECTED TAX

46. There are two main alternatives to consider under this head. Local authorities could assess and collect local income tax at locally determined rates on information made available by this Department. Such a system presupposes

that the local tax system (the tax base and admissible deductions etc.) would conform to the national tax system. Alternatively local authorities could collect the local income tax wholly independently of the national tax system. This would give them freedom to vary the computational rules and the tax base as well as the rate charged. The first scheme is broadly that proposed by the Royal Institute of Public Administration in 1968 which was examined in paragraphs 11 to 21 of Memorandum A of the Board's evidence to the Commission on the Constitution. This analysis remains relevant. It should, however, again be remembered that these earlier comments were related to proposals for a relatively small number of large regional authorities. For the smaller authorities for which taxing powers are now contemplated the difficulties and objections identified in that analysis would be heightened.

47. The Committee will no doubt wish to bear in mind also the implications of the view expressed by the Commission on the Constitution that they "did not believe that under a system of devolution within the United Kingdom people in the regions would want devolved taxes at any cost". (Report, Appendix C, paragraph 2.)

Manpower Costs

48. It is exceptionally difficult to estimate the manpower requirements of the forms of LIT described above. This is difficult enough in terms of Inland Revenue staff involved; it is more difficult to try to estimate numbers of local authority staff which might be required and it is almost impossible to quantify the total additional burden on employers. We have nevertheless attempted, as we did for the Commission on the Constitution, to estimate the staff costs in relation to the schemes discussed in the present Memorandum. For the schemes of LIT for which the Revenue would be responsible the additional staff numbers (in the Revenue) are estimated to be about 16,000 with a non-variable rate and about 22,500 with locally variable rates. For a scheme in which the work would be spread between Revenue and local authorities the staff costs would depend upon the extent of duplication, but if the LIT was assessed and collected on Revenue information by local authority staff the additional staff required in the Revenue would be about 15,000: the local authority staff costs would probably be at least as great as the Revenue's but without further information which we are not in a position to supply (such as the extent to which existing rating staff in the second tier authorities could be used for LIT, e.g. on collection) it is difficult to make an estimate. (In our Memoranda to the Commission on the Constitution, we envisaged that the local authority staff costs for a comparable scheme related to 11 regional authorities would be considerably greater than the Revenue's.) The costs for a completely autonomous LIT would no doubt be significantly higher. At 1974 salaries, the Revenue staff costs alone would be in the region of £30m.-£45m.; and a scheme which involved both the Revenue and local authorities would cost at least £60m. and probably a good deal more. To these figures would have to be added the cost of additional staff to employers. Some work has been done on these costs by independent management consultants, and this suggested that there might be a relationship of rather less than one-for-one between employer staff costs and public service costs.

49. This memorandum has concentrated so far on considering forms of LIT which correspond in character and quality to the national income tax. The point has already been made in the opening paragraphs that at some sacrifice of equity and of the taxpayer's sense that the system is fair it would be possible to produce a more rough and ready LIT. A major means of short-cutting existing procedures at national level for LIT purposes would be to set up a separately administered autonomous LIT based on the principle of self-assessment. Self-assessment has not been introduced at the national level and it is not at present intended to introduce a scheme of this kind. Local authorities, however, already have a good deal of information about taxpayers' income mostly on the basis of self-assessment: this is required for rate rebate claims and for student grants. But this is not, of course, to suggest that there is anything like the basic structure of a system of this kind already in existence. For any reliable system of self-assessment which has the respect of taxpayers some system of checking information would be indispensable and the task of cross-referencing to national tax records would add considerably to the work burden of a self-assessed LIT. Indeed, the idea that a tax is made feasible by throwing a great deal of the burden of operating it upon taxpayers themselves and by sacrificing equity for simplicity may be delusive. Unless elaborate and expensive cross-checks are built into the system the revenue losses may be considerable as a result of a lower level of taxpayer compliance and the greater scope given by a self-assessment system to understate income and make errors of all kinds. To counter such losses it is common to find that self-assessment systems incorporate rigorous and mandatory penalties of the kind for which there is little precedent in the direct tax field in this country. While we have a number of reservations about the acceptability of a self-assessed LIT it can hardly be suggested that it could not be made to work. Given the lack of practical experience of self-assessing in this country it is difficult definitively to rule out a system of this kind as unacceptable and it may be desirable that if some new source of local revenue has to be found (and the emphasis must surely lie on the necessity of finding a new source) the possibility that an autonomous self-assessed LIT would suffice may be worth further and fuller examination.

LIT ON BUSINESS PROFITS

50. It has been assumed so far that as regards LIT there is no justification for making a distinction between those charged to tax under Schedule D on trade and business income and other taxpayers. The implication is that the taxation of, for instance, sole traders would be determined by their principal residence rather than where their profits were earned. Thus a trader living in one area with his factory or shop in another would pay tax only to the former. But it may be suggested that while residence is an adequate basis for the local allocation of employment income (because it brings together benefits received and taxes paid), in the case of business profits it is by no means so clearly appropriate. The business profits are earned at the place of business and it may be suggested that the community benefits related to the place of business are at least as important as those related to the taxpayer's residence. But the

difficulty about this line of argument is that the allocation of profits on a source basis presents such difficulty that even at the regional level where the problems would be less daunting, the application of a source principle has been found not to be feasible. The problem is described in paragraphs 64 to 67 of the Board's Memorandum to the Commission on the Constitution; admittedly these are written by reference to companies but the problems in the case of the larger sole trader are entirely comparable.

51. If (as we would submit) a source basis is not feasible, the LIT charge must be on a residence basis. But this raises the distributional impact of such a charge. The interaction between any local income tax and rating must be considered; if LIT superseded only domestic rates the sole trader would find himself bearing both LIT and his non-domestic rate burden. If companies were not similarly charged the sole trader would feel that he was bearing a disproportionate burden. If, on the other hand, he were exempted either from LIT or from non-domestic rates other difficult issues would arise. If LIT were a significant revenue source there would be a general feeling among employee taxpayers that once again they had been disadvantaged compared with those charged to tax under Schedule D. There is already a widespread view at national level that the rules of Schedule D provide greater scope to taxpayers to reduce their burden than are available for Schedule E taxpayers and to appear to give more substance to this resentment by exempting the business community from local income tax would be a questionable step. If, on the other hand, sole traders were exempted from non-domestic rates it might be suggested that they had been advantaged against their corporate competitors who would still be chargeable, and while any resentment on this account would be tempered by the knowledge that the sole trader was being charged to local income tax, it might not be completely appeased, particularly if the non-domestic rate burden were high.

Companies

52. Reference has already been made to the Board's evidence on local company taxation to the Commission on the Constitution. (Memorandum A, paragraphs 53 to 71.) The problems discussed in those paragraphs apply *a fortiori* to devolution below the provincial level. It should be added that the number of those with the expertise necessary to deal with difficult questions of the kind discussed in those paragraphs – in particular those relating to the allocation of profits – is barely adequate for present needs. Recruiting and training staff for the lower grade tasks which arose in relation to employment income would be difficult enough; for the higher grade work involved in allocating corporate profits the difficulties of recruiting and training staff would be even greater.

53. It follows that if these difficulties prevent company profits from being charged to LIT but not the profits of sole traders or partnerships which could be charged, however imperfectly, on a residence basis, the competitive balance between non-corporate and corporate traders could be disturbed: both could be left with their non-domestic rate burden to which would be added in the case of sole traders and partnerships the LIT burden which would not exist for companies.

SUMMARY OF CONSIDERATIONS RELEVANT TO LIT

54. The two factors which most of the proposals for local income taxes have in common are (a) that the taxation basis should be that used for the national tax and, that the tax should be collected at national level; (b) that the tax charge should be the product of applying locally variable rates to the national tax base. Advocates of local income taxation would probably concede that the power to vary should be confined to the 66 county level authorities and not extend to the 454 lower tier authorities. The upper tier authorities also, it is presumed, would be the recipients of the tax. It is for this reason that the present memorandum has concentrated on surveying the technical and administrative problems which arise in relation to LIT surcharge at county level. Paragraphs 28 to 49 survey these problems afresh but the central problem remains the massive administrative effort that would be necessary both within and outside government service to establish a viable system which would have the confidence of taxpayers and encourage their compliance. We have not sought to distract the Committee by trying to go over all the ground for autonomous local direct taxation. This was exhaustively considered in relation to provincial authorities in the evidence we gave to the Commission on the Constitution and we have already commented on the greater difficulties which arise from the form which local government has taken (paragraph 19).

55. Looking at the suitability of an LIT imposed centrally but at locally variable rates the following points have emerged:

- a. The buoyancy of national income tax is primarily a product of fiscal drag. With rising inflation this has become a suspect feature of income tax and it would be imprudent in the long run to rely on year on year inflationary buoyancy of the kind which has been noted with approval by advocates of a local income tax.
- b. Whether LIT promoted a sense of local fiscal responsibility would depend upon its form and its machinery. A surcharge type of LIT would be obviously less locally identifiable than an autonomous LIT. On the whole, however, if the residence basis prevailed the sense of fiscal responsibility would be in principle no less than with rates. But this is subject to the consideration that the LIT would be a county level tax and as such would be less immediately identifiable with the expenditure of the district councils. But, as has already been suggested in paragraph 28c, if LIT became the top-tier tax and domestic rates the second-tier tax, the sense of fiscal responsibility could be stimulated. There are, therefore, a number of counterbalancing factors here but in sum it cannot be said that an LIT would inevitably have the effect of promoting a sense of local fiscal responsibility more appreciably than the rating system.
- c. There is a difficult issue relating to the interaction between variable local taxation and assistance from central government. In so far as a variable LIT would permit some authorities to charge their taxpayers more than others on the same income the question arises of the justification for the higher charge. The presumption would be that

central government equalised resources on some basis of parity or fairness as between authorities. Thus if one authority is charging more tax than another it may be doing so in order to support a higher level of services or in order to obtain a true measure of parity which grants from central government do not permit it to achieve. In either case there is a danger that the heavier than average income tax burden of particular local authorities would get absorbed into the assistance required by those authorities for some future year. There would therefore be some danger of a ratchet effect between central grants and the product of a local income tax.

- d. From the point of view of certainty of yield there would be little to be said against an LIT.
- e. How important a problem confidentiality would be would depend upon the nature of the LIT. With a national supplement at locally variable rates a taxpayer's income could easily be estimated and there would undoubtedly be a greater fear of disclosure locally than at the national level.
- f. The impact on incidence and distribution would be an important factor. The addition of a local authority supplement to national rates of tax would make worse the particularly acute sense of burden felt by those becoming liable to pay tax at the basic rate. The first step from no liability to liability is already high at 33p in the £. Leaving on one side for the moment the question of the extent to which United Kingdom top marginal rates would constrain additional rates charged for local authorities, the impact of the local supplement can be judged by considering the case where with rising income or a change in his entitlement to personal allowances a taxpayer comes for the first time within the charge to income tax. He will then find his marginal take-home pay reduced by the basic rate of income tax at 33p in the £ plus, as from April 1975, the 5½ per cent earnings-related national insurance contribution¹ plus an LIT of something like 4p in the £ - a total burden of 42½p in the £. Whether LIT rates as high as 4p in the £ could be charged would depend, *inter alia*, on some solution being found to the problem of the top national marginal rates of tax, but it could prove unrealistic to assume that the margin of two percentage points theoretically available for an LIT with the present top marginal rates of national tax represents the highest rate at which an LIT might, in practice, be charged. Even at relatively low rates the total impact of LIT could be significant for a household consisting of several relatively low wage earners. Similar considerations would apply in the case of those not paying rates or full rates under the present system, e.g. farmers and those enjoying rate rebates. It is obvious that distribution and incidence would be less seriously disrupted in such cases if the LIT rates were very low. But the yield would then be marginal and the cost of collection would be high. The higher the yield derived from the tax and hence the more cost-

¹ Payable on earnings up to £69 per week.

effective it is likely to be the more serious are likely to be the incidence and distribution problems arising as a result of the interaction with other charges reducing take-home pay.

g. It has already been established that LIT would necessitate end-year assessments for taxpayers. The burden of LIT would therefore be perceptible and the tax would have to be paid in arrear. It does not follow that the payments would necessarily have to be made through the tax collections of the following year. They could be made directly. Either way there could be difficulties for taxpayers whose earnings varied considerably from year to year: the situation could arise in which a taxpayer was trying to pay high local tax out of low current income. While this is not desirable it may be unavoidable. Payment in arrear would moreover weaken the link between tax and expenditure; the sense of fiscal responsibility depends upon a direct link between the two; but when the expenditure appears to antedate the payment of tax the link may be weakened.

56. Matched against these tests of suitability the LIT is ambiguous. Over much of the field it would do as well as the rating system at present does but not much better. In some respects (e.g. confidentiality, incidence and distribution and on impact on national tax policy, timing of payment) it would leave something to be desired. The central question, therefore, remains whether, given that little clear advantage appears to reside in relying upon a LIT as a successor or as a significant supplement to the rating system, the massive administrative effort and cost which would be necessary to bring the system into being and to maintain it would be justifiable. In our judgment it would not.

OTHER DIRECT TAXES

57. For the other direct taxes the choice between a centrally and a locally administered local tax does not really exist. It would be beyond contemplation to propose, even at county level, separately locally administered taxes on, e.g. the transfer or passing of property. These other taxes are in general of such speciality and are so dependent on legal form and practice that any attempt to disperse administration could have no merit. The choice is, therefore, between transfer/hypothecation arrangements on the one hand, or charging local authority supplements, possibly at varying rates, on the other.

Corporation Tax

58. It remains a theoretical possibility to transfer or hypothecate corporation tax to local authorities. There are two sets of objections. First, that such arrangements assume that there is some basis on which the tax could be allocated to local authorities. But as has already been indicated the problem of the allocation of company profits would defeat this. Second, like income tax, corporation tax is a major instrument of economic and monetary management at the command of central government. Given the importance of the corporate sector it is inconceivable that central government could forfeit the power to take decisions affecting levels of investment, company liquidity and profitability.

The ability of central government to act as necessary in relation to policy objectives affecting the corporate sector could not be allowed to be constrained by the implications of any changes on local government financing.

Tax on Capital Gains

59. In the discussion so far it may have been assumed that the local tax on income and profits could extend to charging the capital gains realised as part of a taxpayer's total income, the main constituent of which may be employment income or business profits or, in the case of companies, trading profits. But capital gains are more correctly seen as relating to capital rather than to income. The gains are separately charged to national tax at rates reflecting the lower taxable capacity they have due to, for instance, the period over which the gain has accrued or the inflationary element in it. Correspondingly at the local level, gains would have to be separately charged and (given the considerations which have led to lower rates being charged nationally) at local rates below the rates of tax charged on income. This would add something to the work of taxing gains, but a much larger problem would be the allocation of the tax. If the capital gains tax was supplementary to a LIT on the residence basis, this basis would be regarded as less satisfactory than for income. But it would be very difficult to arrive at any very satisfactory 'location of assets' basis for the many different types of asset concerned and certainly any such basis would add considerably to the work burden.

60. It might be suggested that the tax on capital gains of individuals could be transferred in total as a local authority revenue source. This proposition was examined – in relation to provinces – in Section 5 of the Board's Memorandum A to the Commission on the Constitution and the considerations discussed in those paragraphs remain relevant. The basis of allocation (the residence of the taxpayer rather than the physical location of the assets on which the gain was made) would not be found satisfactory. The yield (£320m. for 1974-75) is above the minimum threshold for hypothecation (see paragraph 28e), but there remains the problem of the uncertainty of yield, reflecting as it does the state of the markets and the turnover of assets. Looking at the tax against the criteria of suitability in paragraphs 5 to 13, its *buoyancy* would be suspect (depending so much upon inflation and market forces); it would have no particular virtues from the point of view of local fiscal responsibility because of its fortuitous nature; its distributional effects would be unpredictable and random; its yield both modest and erratic, and its cost-effectiveness dubious. We would not see it as suitable for transfer to local authorities. The third possible form which a capital gains tax could take locally would be if it were run as an autonomous tax by local authorities.

Capital Transfer Tax

61. Of the other direct taxes, by far the most significant is the capital transfer tax – the successor to estate duty. There are two ways in which it could form a new source of revenue for local authorities. On the one hand it could be transferred or hypothecated as a local authority tax without the economic management problems that would arise in relation either to income tax or corporation

tax. Problems might arise as a result of the interaction between national taxes on income and capital with a local capital transfer tax and these might be less easy to resolve if the latter were a transferred tax. The likely yield of capital transfer tax would not be inappropriate for a transfer or hypothecation arrangement.

62. The question of suitability, however, remains. One of the reasons why the Commission on the Constitution took the view that estate duty could not be considered as a useful candidate was that it seemed inappropriate that a particular region in a unitary state should have the right to operate a once-in-a-lifetime tax on total world assets. The capital transfer tax will not necessarily be a once-in-a-lifetime tax but it will remain a charge on total world assets. It will moreover raise the same range of practical and technical problems discussed in Section 7 of the Board's Memorandum A to the Commission on the Constitution. It remains the fundamental objection that the areas with the greatest concentrations of wealthy residents would benefit most if the domicile basis were chosen and would therefore be able to impose lower rates of duty thus encouraging further numbers of wealthy taxpayers to settle there. The general suitability of a tax of this kind as a significant source of local authority finance is also questionable. As a tax on transfers of capital the tax base would be rather narrow and insofar as the criteria of suitability identified in paragraphs 6 to 15 above apply to a tax of this kind, they do so only to throw doubt upon it as a source of local revenue. In particular, as the number of taxpayers affected would be relatively few, local fiscal responsibility would not be increased; the problems of demand management associated with a tax such as this have already been noted (paragraph 15).

63. The alternative to transferring or hypothecating capital transfer tax would be to charge a supplement at the national level on behalf of the local authorities. But as a 10 per cent supplement would only produce some £30m., and could because of the narrowness of the tax base have such acute distributional effects in particular cases, this possibility is not one that merits pursuit.

Wealth Tax

64. The objections to transferring or hypothecating the capital transfer tax to local authorities would apply to the proposed wealth tax. However, the detailed form of this tax has yet to be determined. The form will determine the yield and while yields of between £200m./£275m. and £350m./£425m. are used illustratively in the Green Paper these estimates may be in excess of the ultimate yield of the tax as the wealth tax base could be eroded by reliefs introduced as the result of further public discussion of the tax. Should the tax yield be significantly less (e.g. because of changes in the form of the tax or its rates) it seems unlikely that the yield would be sufficient to make it as significant a potential source of local revenue as the capital transfer tax.

65. With this range of uncertainty it is difficult to examine the practical considerations. If, therefore, for reasons which are not immediately obvious, this tax is seen as a likely future source of local government revenue we trust that there will be a further opportunity to examine in detail its merits and the technical and administrative issues which would arise.

The Stamp Duties

66. The practical considerations which weighed against the stamp duties being allocated to the larger provinces which were in contemplation when the evidence for the Commission on the Constitution was prepared apply *a fortiori* to the allocation of these duties to smaller local authorities and we would not at this stage wish to add to the considerations advanced in Section 6 of Memorandum A to the Commission on the Constitution. With an estimated yield for 1974-75 of in all some £189m. these duties are at best only a marginal new source if totally transferred or largely hypothecated to local authorities. If the charge was broken up under its various heads and certain of those heads allocated to local authorities the arrangement would become even less attractive. With a yield as relatively small as this the question of applying a surcharge nationally for local authority purposes would not seem to arise.

OVERSEAS EXPERIENCE

67. It is frequently suggested that experience of local taxation systems of other countries might be helpful in appraising the scope that exists in relation to the United Kingdom and the problems that might arise. It is understood that the Layfield Committee has expressed interest in what may be learned from overseas comparisons. The following section of the memorandum provides information about direct local taxation in a number of comparable developed countries.

68. As a preliminary, the table at Annex III compares the public revenues and taxes of the United Kingdom with those of other developed countries. It shows that the total 'local' taxes (including property taxes comparable to rates levied on occupiers in the United Kingdom) as a proportion of the total taxes range widely – from about 47 per cent in Canada to less than 2 per cent in the Netherlands. It should be noted, however, that in Federal states state taxes have been counted as local taxes. Total *direct* local taxes as a proportion of total taxes range no less widely from about 50 per cent in Switzerland to nil in Australia. The figures confirm the diversity of the tax systems of the countries considered; no common relation between GDP, national and local taxes is apparent and the absence of any such optimal relationships reflects the historical, geographical, social and economic factors which have all played a part in shaping the systems.

69. Throughout the world are found many different types and combinations of direct local taxes. This diversity is illustrated by the table at Annex IV which shows for each country selected the tiers of government which have the right to impose tax or to share in the revenue. It is outside the scope of this memorandum to analyse the way in which expenditure is shared among the different tiers, but it will be seen that the bodies having authority to levy the various forms of local taxes range from states and provinces in North America as large or as populous as some European countries, to small urban and rural authorities in France, Scandinavia and Switzerland. Property taxes exist in various forms in most countries, even where most revenue is derived from other taxes, or they may be the principal source at local level as in North America

and Australia. Taxes on real property are normally based on the capital value in North America and some European countries and may apply to owners rather than occupiers as in the United Kingdom (landlords may, of course, pass the tax on to their tenants). In some countries personal property is also taxed by local authorities.

70. Annex V analyses in greater detail in tabular form the local direct taxes in each of the selected countries on as uniform a basis as possible (payroll taxes are excluded). Where, as a matter of practicality, it has not been possible to provide a comprehensive description of the tax systems operative at all levels of administration, the table provides examples typical of the various levels. Federal states, such as the United States, are almost impossible to deal with on a comprehensive basis within the confines of this memorandum. International comparisons of this nature are difficult to make and may be misleading because of differences in structure and in the extent to which responsibility for providing various services is borne by central government or local authorities, and in the extent to which expenditure by the local authorities is met by grants from central government financed out of national taxation. The table cannot, of course, provide any means of gauging how successful any local tax is in fulfilling the role for which it was intended or which has been imposed upon it.

71. The power of regional or local authorities to levy direct taxes is often associated with a federal structure of government reflecting greater cultural and ethnic diversity, and a longer tradition of local autonomy or separatism in recent times than is true of the United Kingdom. In the USA, Canada, Germany and Switzerland the states and provinces have their own legislatures and the system of local government may vary considerably within the federation. In the main countries which have them, regional or local taxes have either grown up with the national income tax or in some cases have preceded it. From the geographical point of view some of the states of the USA are larger than some of the countries in the comparative table; size and patterns of public expenditure and the levels of taxation power reflect resistance to centralisation rather than devolution. For example, a state income tax existed in some states of the USA long before the federal income tax was introduced. In Switzerland, cantonal income taxes have existed since the nineteenth century and it was not until 1940 that the federal income tax was introduced as a defence tax.

Sweden

72. To appreciate these differences and to illustrate the difficulties which may arise as a result of the interaction of national policy and taxes with local policy and taxes the case of Sweden is illuminating. Only the Swedish Parliament can make law but there is a long tradition of local government. The division of the country into 'kommuner' dates from the middle of the nineteenth century before industrialisation when 90 per cent of the population lived in the countryside. In recent years the number of kommuner has been greatly reduced (from 2,500 in 1952 to 280 in 1974) to create more viable units in order to discharge increased responsibility (especially for education) and to secure greater uniformity of services. The statutory definition of taxable income applies throughout the country but the local authorities are in principle free

to determine the rate for individuals and companies within their jurisdiction. This freedom has, however, been modified by recent developments. Central government tax equalisation grants have been made since 1966 to ensure uniform standards especially for those authorities lacking industry and therefore a fairly wide tax base. It is also significant that because there was a danger of local authorities' expenditure pre-empting central resource allocation, at the request of national government rates of local income tax were frozen for 1973 and 1974 having risen from an average of less than 10 per cent of taxable income in the 1950s to nearly 24 per cent in 1972.

73. Sweden has a system of 'preliminary' or 'pay-as-you-go' personal taxation similar to that of the USA. It is based on the registration of every individual who is a resident of the local authority area for both national and local taxes which are collected in a single deduction. The system is not as highly developed as the cumulative PAYE system in the United Kingdom which aims to collect the correct amount of tax from the great majority of wage and salary earners by the end of the year; as a general rule in Sweden the notice of demand and the tax table sent with it to the taxpayer at the beginning of the year govern his 'preliminary' liability for the whole year, despite changes of status or address during the year, and the amount of tax due is not finally determined until after the year has ended and the taxpayer has sent in his return.

Other Countries

74. Of the other countries surveyed in the Annex, the USA, Canada and Federal Germany merit special comment.

USA

75. One of the main sources of locally raised revenue remains the property taxes which have long existed, but in recent years the property tax base has been steadily eroded by reductions and exemptions, particularly for the elderly and poor, and the local authorities have therefore increasingly sought other sources of revenue. Various systems of local personal income tax apply, sometimes with the gross income for federal tax purposes as the starting point. There are varying deductions or personal allowances, and rates may be progressive (as in New York State and City shown in the Annex) or proportional as in Pennsylvania. Where there is an income tax on corporations, complicated formulae based on factors of property, payroll and sales receipts are in use to determine the 'business allocation percentage' applicable to the income of local corporations with a place of business outside the jurisdiction of the taxing authority, in order to arrive at the proportion of income to be subject to the local tax. This income may be subject to a flat rate tax (e.g. 9½ per cent in Pennsylvania), or there may be a 'franchise' tax as in New York where the tax payable is whichever is the greatest of four computations (a flat rate of 9 per cent of the allocated income, a percentage of the allocated capital, a percentage of part of income and payroll, or \$125).

76. The tiers of authority levying direct taxes range from the states to school districts as in Philadelphia (see Annex). It is significant that the various local

taxes on income are deductible for, or credited against, the taxes charged by higher authorities (including federal taxes), so that any increase in rates of tax by the lower tiers tends to diminish the tax base or revenue of the latter. This is also true of the estate and gift taxes, examples of which are shown in the Annex. In addition there are various taxes comparable to the national stamp duties in the United Kingdom, on mortgages, transfers of stock and real property and capital issues.

Canada

77. The municipalities levy property and business licence taxes and are not allowed to impose new kinds of taxes. They receive grants from the provinces which have power to raise taxes on the incomes of individuals and corporations and which do so under a wide variety of systems. In Quebec the personal income tax is quite separate from the federal income tax but elsewhere it takes the form of a surcharge on the federal tax. It is of interest that a recent change in federal tax law under which the personal allowances and rate bands are automatically revised annually in line with the consumer price index, has caused problems for the provinces by diminishing their tax base.

Germany

78. The local authorities raise revenue by property taxes and the Gewerbesteuer (Business Tax) which has existed since the nineteenth century and is a municipal tax regulated by federal law. It applies to the income arising in Germany and the capital employed of all businesses (whether or not incorporated), the local authorities having the power to fix their own multiple of the basic rates set by federal law. Until recently the local authorities retained the entire yield, but as those with little industry or commerce were at a disadvantage, it was agreed in 1970 that part of the tax should be passed on to the provincial and central government in return for a share in federal income tax derived from their area. Where a business has an establishment in more than one place the tax payable is allocated according to a formula usually based on payroll and turnover. The business tax is deductible for federal income taxes.

SUMMARY OF EARLIER ENQUIRIES INTO LOCAL TAXATION**PRE-1969 EXAMINATIONS****1. 1899 Royal Commission on Local Taxation**

The Royal Commission examined a proposal for a local tax on income from non-rateable property. The main conclusion was that it would not be possible to ascertain sufficiently accurately to what district an income should belong, and the idea was rejected on the grounds of administrative difficulty.

2. 1912-1914 Departmental Committee

A general local income tax was considered but the conclusion was that the administrative difficulties were overwhelming. The specific proposal, by Lord Aldwyn, had been for a local tax on earned and overseas income to be related to the residence of the recipient and on unearned income to be based on the area from which the income derived. The difficulties on which the scheme foundered were those of allocating income to areas, the risk of evasion and the large administrative cost.

3. 1956: Study by the Royal Institute of Public Administration

The RIPA devised a local tax, most of which was to be derived from a surcharge on companies' payrolls, without, however, providing for differentiated personal allowances or other refinements. In 1968, the Royal Institute re-examined these proposals and brought out a more complex scheme. Corporate profits would be excluded, except for close companies. The Revenue would notify local authorities of taxable income and allowances and the authorities themselves would have discretion to levy different local rates of income tax up to a maximum stipulated by Parliament. The relationship would have been comparable to that existing for rating, where the Revenue provide the valuation while the local authority determines the poundage. In the event, the RIPA itself favoured some different source of local revenue (generated by reference to motor vehicles) because of the high cost of assessment and collection of a local income tax. However, the Revenue, in presenting its evidence to the Commission on the Constitution, examined the RIPA scheme in some detail and its conclusions are summarised in section 6 below.

4. 1968: Institute of Municipal Treasurers and Accountants

The Institute favoured a local tax on both personal and corporate incomes, because its incidence could be precisely controlled and its yield would be buoyant. It acknowledged the drawback: the cost (because of duplication of effort in assessment and collection by local and national authorities) and the need for a device for equalising resources between local authorities in relation to need. It put much faith in the benefits of computerisation (by local authorities as well as the Revenue) in overcoming the administrative difficulties and making the scheme a feasible proposition. For companies, the tax would have been in effect a kind of super rating by reference to profits but the personal tax would have been more complex. Under it, the local authority would have maintained personal records for each taxpayer compiled from the electoral register (and revised each October). The return for electoral purposes would have had to be expanded to show all persons in the household, irrespective of age and also to specify the nature and source of any income. The qualifying date for the electoral register would have determined for each taxpayer the appropriate local taxing authority for the ensuing financial year, irrespective of any subsequent change of residence in that year. A change of job, however, would have made the system more complicated to run since collection in the main would have been through employers, who would have been provided with tax tables by their local authorities (as well as by the Revenue). A change of job from the area of one local authority into another after the qualifying date would have involved the new employer in the operation of tax tables for two (or more) authorities.

5. The proposals would have involved a great deal of additional work. The IMTA recognised this fact but remained of the view that a locally administered PAYE would be the most effective scheme. The assessment of non employment income would have depended on notification from the Inland Revenue. As regards relevant overseas experience the Institute took account of the operation of local taxes in Scandinavian countries but recognised that comparison with the UK was difficult on two counts:

- (i) the scale of economic activity was small in relation to the UK;
- (ii) there might be significant variation in the role and organisation of local government in other countries compared with the United Kingdom pattern.

6. Commission on the Constitution

(1) The summary in this section will cover

- a. Revenue evidence, as presented in the Memoranda dated December 1969, July 1970 and July 1971;
- b. Commission's Report and Recommendations;
- c. Subsequent action.

Memorandum of December 1969

(2) This paper examined the technical and administrative feasibility of transferring various direct taxes wholly or in part to regional authorities. The specific duties considered were income tax (and surtax), corporation tax, capital gains tax, stamp duties and estate duty. The principal candidate was thought to be the income tax and two main alternative schemes were considered in detail

- (i) the RIPA scheme published in 1968 – see Section 3 above; and
- (ii) A scheme under which the local authority would fix the tax rate but assessment and collection would be in the hands of the Revenue.

For both schemes, it was assumed that the province in which the taxpayer had his principal place of residence should have the exclusive right to tax that person's whole income.

Income Tax: The RIPA Scheme

(3) The difficulties of identifying the province of residence and communicating details of total income to the provincial authority were not thought to be insuperable, although the memorandum in 1969 was based on a concept of regional authorities related to the Redcliffe-Maud proposals for a handful of large provinces. So far as timing was concerned, it might be a year or more after the end of the income tax year that the local authority would be able to get final figures of total income from the Revenue, but that problem could be met by arrangements for payment on account. The big difficulty was cost. Even on the basis of devolution to the Redcliffe-Maud provinces, the Revenue estimated the additional staff required as 4,500 by the Revenue and 50,000 by local authorities.

Income Tax: a Centrally Administered and Collected Tax

(4) Under this scheme there could have been one national range of income tax rates and eleven different provincial rates. The Revenue concluded that under PAYE, the use of a ready reckoner for the calculation of the provincial addition, or the use of separate tax tables for provincial rates was possible but only at the cost of a significant increase in the burden of work falling on the employer and on the Inland Revenue. Additional Revenue staff alone might have been about 8,000. For income not taxed under PAYE deduction of local tax at source would not have been feasible if a variety of local rates of tax had to be used and the only workable solution was thought to be direct assessment to provincial tax by the local authorities themselves. This tax would entail a very substantially increased administrative burden for both local and central authorities.

(5) The Revenue view was that there were two ways of imposing a local income tax. Either the provinces would have to do the work on information supplied by the Revenue – which both would find massively expensive – or the provinces, like the Revenue, would have to put as much of the burden as possible on employers and pick up the tax on non employment income by direct assessment. That too would be a very expensive process and the use of computers and the Post Office Giro were thought to be only marginally relevant to the problem of cost.

Local Surtax

(6) In 1969 the organisational problems involved in a local variant of surtax were thought to be much less formidable than for income tax, on the basis that the bulk of the work would be done by the Surtax Office. Since then, however, surtax has been abolished and higher incomes are now subjected only to income tax at basic and higher rates.

Local Company Tax

(7) Two major objections were made to a local tax on companies. The first was that control of the rate of corporation tax was (and is) an important instrument of economic policy the use of which the Chancellor would wish to retain within his discretion. The second was wholly practical in that it would be most difficult to establish a satisfactory basis for allocating profits to local authorities. The place of central management and control would not necessarily represent a suitable definition since it would distort the distribution of regional company taxation heavily in favour of London and the South East, even though the profits of many companies were actually earned in factories located elsewhere. Assessments made by reference to the area where the profits arose would involve companies in an intolerable burden, in maintaining new records and new accounting procedures to support a provincial tax based on a permanent establishment basis. A new body of legislation would have been needed and the task of implementing it would have been very great.

Local Capital Gains Tax

(8) This was not thought to be a strong candidate, since the estimated yield was small. Moreover, with the exception of real property, most assets liable to capital gains tax would not have been easily attributable to local areas on the basis of physical location of the asset itself, because of the danger of switching from one area to another and the problem of setting off losses in one area against gains in another, so that allocation of the tax to provincial authorities would have had to be made by reference to the residence of the individual.

Local Stamp Duties

(9) It was not thought that adequate ways and means could be devised for collecting and apportioning stamp duty on a provincial basis. Overseas experience suggested that transactions in land and property and share transfers might be the most likely candidates but a disproportionate part of the revenue would arise in the South East and neither would provide a balanced yield for provinces as a whole. Any measures to counteract the imbalance could give rise to considerable complexities.

Local Estate Duty

(10) It was thought that, with some important modifications, a local estate duty could work but since the total yield from estate duty was only some £380m. it was thought questionable whether it was worth considering as a candidate for local variation.

General Conclusions

(11) The conclusion was that there would be very substantial administrative and technical difficulties in operating on a provincial basis any of the duties within the Inland Revenue field.

Additional Memorandum of July 1970

Separate Direct Taxes for Scotland

(12) At the Commission's request, the Revenue prepared a paper on the possibility of giving a separate Scottish regional government revenues in the general field of direct taxation, without 'excessive administrative complications'. There was already in existence in Scotland the nucleus of a separate tax administration, in the local tax offices and the Centre at East Kilbride. It was thought that Scottish Government alone could be given power to vary the income tax rate at substantially less cost than if that power had to be operated over eleven different provinces in the United Kingdom as a whole, but in any event it was not considered practicable to confine separate taxing powers to Scotland since Wales at least would also be a candidate for similar treatment. Administrative considerations apart, however, it was thought that such a scheme was unacceptable, simply because it would deprive the central government of an essential tool in controlling a substantial part of the economy.

Additional Memorandum of July 1971

(13) Following the 1971 Budget proposals for the unification of income tax and surtax, the Revenue submitted a further paper. It was not thought that the change of the personal tax system substantially affected the main conclusions in the earlier papers. On the contrary, the establishment of the unified system was thought to rule out any consideration of local surtax.

The Commissioner's Report – October 1973

General Conclusions

(14) The Commission originally had in mind that the regions might be financed entirely from independent regional taxes, but soon concluded that this would not be possible since the practical scope for independent regional taxation was too restricted in relation to the likely scale of regional expenditure. The poorer regions, because of their low tax yields and high expenditure requirements would in any event require substantial grants from United Kingdom funds. (Report, paragraph 617.)

(15) It was recognised, too, that the central government's ability to vary rates of direct taxes and particularly of income tax, was an important instrument for regulating demand and redistributing income within the country as a whole, particularly when used in conjunction with the social services and cash benefits. It therefore did not follow automatically that a tax which could be operated

regionally should in fact be devolved to regional governments. On balance, however, the Commission thought that "if the total volume of taxation taken out of central hands were not too great and the regions' powers of varying it not too extensive then the United Kingdom government might well be able to tolerate some overall loss of control, thenceforth allowing for the independent financial actions of the regions much as it now allows for the independent financial actions of large commercial enterprises". (Report, paragraph 621.)

(16) The Report recognised that regional taxes did exist in Europe and were not precluded in the EEC but accepted that it was difficult to think of introducing independent regional taxes in the United Kingdom for the first time when the European trend was towards harmonisation.

Specific Conclusions on Direct Taxation

(17) The Commission felt unable to make definite recommendations about regional taxation. It accepted the general conclusion of the Inland Revenue that there would be very substantial administrative and technical difficulties in operating on a regional basis any of the direct taxes extant then, but some limited possibilities were noted.

(18) The accent of the Commission's enquiries was on administrative and technical feasibility and in their Report they stated that they "did not believe that under a system of devolution within the United Kingdom people in the regions would want devolved taxes at any cost". There would be the expectation of operational efficiency, reasonable economy in the use of administrative resources and equity in taxation as between all citizens of the United Kingdom. People would not be content with small and unimportant devolved taxes, or taxes which could not be readily identified as belonging to their region (or could be avoided by the removal of taxpayers to another region with a lower rate). All these considerations made it difficult to formulate recommendations.

Income Tax

(19) Since it was felt that any tax devolved should affect as broad a section of the regional electorate as possible, income tax seemed to be the prime candidate. "Any regional tax on total income should take the form of a supplement to United Kingdom income tax and be centrally administered. The regions would fix the rate of tax but in all other respects, including the determination of allowances, United Kingdom legislation would apply. A regional supplement could not, however, be levied on total income without a radical change towards direct assessment or general self assessment. Such a change could probably not be justified solely as an accompaniment to devolution but the least radical solution which would permit a regional supplement using PAYE on employees' income and direct assessment to the regional tax of all other income (including investment income taxed at source for national purposes) might be worth consideration."

(20) On a more limited scale, there was thought to be some scope for special regional taxes on certain kinds of income only, outside the structure of the main income tax, such as a flat rate regional tax on income from property or

any other conveniently identifiable source. The difficulty about such a levy was that it might be rejected as inequitable unless complemented by measures to cover people who would otherwise escape regional taxation.

Surtax

(21) The Commission thought that surtax in its centrally administered form could have been converted into a regional tax fairly easily but unification with income tax ruled out that possibility.

Corporation Tax

(22) The Commission were "satisfied that a regional tax on corporate profits would be impracticable. There is no satisfactory way of allocating to individual regions the profits of the many companies which operate in more than one region, often on a nationwide basis".

Other Taxes

(23) Capital gains tax and estate duty, with their small yields, were thought to be weak candidates for devolution, although administratively feasible. Similarly, while it might be possible to devolve stamp duty on land transactions, the yield would be small and heavily concentrated in the South East of England.

7. More Recent Developments

The Government published their proposals for the reform of local government structure in February 1971, and while the reform created larger units than had existed before, the total number involved was far greater than that envisaged by Redcliffe-Maud. However, the reorganisation proposals made it necessary to review local government finance and in July 1971 a Green Paper (Cmnd 4741) '*The Future Shape of Local Government Finance*' was published in order "to stimulate a wide public debate on the financial implications of re-organisation and in particular on the financial relationship between central and local government". The document set out for consideration a number of possible additional sources of local revenue, including local income tax, and invited discussion.

Following discussion and consultations with local authority associations and others, the Government published in June 1973 a Consultation Paper on Local Government Finance (in England and Wales). In the paper the Government of the day turned its face against any new local taxes involving "complex administration and collection" since they were engaged in a reform of both direct and indirect taxation and did not think that the public would welcome the introduction of any new duties. It was decided instead to make substantial improvements to the system of central government grants and to the current rating system. So far as the individual ratepayer was concerned, this involved a refinement of the rate rebate scheme to make liability to rates more responsive to ability to pay. The Government proposed a 90 per cent specific grant towards the cost of rebates granted under the new scheme.

ANNEX II A

PERSONAL INCOMES AND DOMESTIC RATEABLE VALUES: COMPARATIVE MAGNITUDE

English Counties 1971-72

Numbers: millions Amount: £ million

34

	Population	Total Net Income			Domestic Rateable Value			Key to Comparison: — Order unchanged x Order more than one place different
		Nos	Amount	Order	Nos	Amount	Order	
Greater London	7.6	3.3	6,042	1	2.5	280.0	1	—
Bedfordshire	.5	.2	355	25	.1	12.0	26	
Berkshire	.6	.3	485	18	.2	17.4	19	
Buckinghamshire	.6	.2	406	23	.2	18.3	17	
Cambridgeshire	.3	.1	178	34	.1	7.1	33	x
Cheshire	1.4	.6	1,007	7	.5	34.8	10	
Cornwall	.4	.1	206	31=	.1	7.6	32	x
Cumberland	.3	.1	171	35	.1	6.1	35	—
Derbyshire	.9	.3	488	17	.3	16.6	20=	—
Devon	.9	.3	475	19	.3	22.0	15	
Dorset	.4	.1	206	31=	.1	10.4	28	x
Durham	1.8	.5	713	13	.6	32.0	12	
Essex	1.4	.5	886	8	.5	35.4	9	

ANNEX II A continued

Numbers: millions Amount: £ million

	Population	Total Net Income			Domestic Rateable Value			Key to Comparison: — Order unchanged x Order more than one place different
		Nos	Amount	Order	Nos	Amount	Order	
Gloucestershire	...	1.1	.4	684	14	.3	23.7	14
Hampshire and Isle of Wight	...	1.6	.6	1,025	6	.5	46.1	6
Herefordshire1	.06	107	37	.1	2.6	37
Hertfordshire9	.4	762	12	.3	29.7	13
Huntingdonshire2	.06	111	36	.1	4.3	36
Kent	...	1.4	.5	812	11	.5	34.3	11
Lancashire	...	5.3	1.8	2,903	2	1.8	102.0	2
Leicestershire/Rutland8	.3	510	16	.3	18.1	18
Lincolnshire8	.3	454	20	.3	15.5	22
Norfolk6	.2	356	24	.3	12.2	25
Northamptonshire4	.2	296	29	.1	10.1	30
Northumberland8	.3	442	21	.3	16.6	20=
Nottinghamshire	...	1.0	.4	641	15	.3	19.4	16

ANNEX II A continued

Numbers: millions Amount: £ million

		Population	Total Net Income			Domestic Rateable Value			Key to Comparison: — Order unchanged x Order more than one place different
			Nos	Amount	Order	Nos	Amount	Order	
Oxfordshire	...	.4	.2	313	27	.1	9.1	31	
Shropshire	...	.3	.1	180	33	.1	6.7	34	
Somerset...	...	.7	.2	347	26	.2	15.3	23	
Staffordshire	...	1.9	.6	1,049	5	.6	36.2	7	
Suffolk	...	.5	.2	276	30	.1	10.8	27	
Surrey	...	1.0	.4	828	10	.3	36.1	8	
Sussex	...	1.2	.5	879	9	.4	48.7	4	
Warwickshire	...	2.1	.9	1,606	4	.6	46.7	5	
Westmorland	...	.1	.03	48	38	—	1.5	38	
Wiltshire...	...	.5	.2	299	28	.1	10.3	29	
Worcestershire	...	.6	.3	439	22	.2	15.2	24	
Yorkshire (East, North and West Riding)	...	4.6	1.8	2,817	3	1.6	79.5	3	

PERSONAL TAX OR DOMESTIC RATE RECEIPTS: COMMENTARY

Coverage

1. These tables present the average personal rate of tax, on a county basis for England and on a country basis for Scotland, Wales and N. Ireland for 1971/72, and estimate in each case the addition to that rate required to raise an amount of revenue equal to domestic rate receipts for the same year. The tables also provide details of population and of numbers and amounts of total net incomes liable to tax, net investment incomes and profits (including professional earnings) assessable under Cases I and II of Schedule D.

Method

2. Income details are taken from the 1971/72 Survey of Personal Incomes but tax details were not available on a county basis. The tables therefore give for the English counties two different figures under "Average Personal Tax Rate" and the truth will be somewhere between them. Column 1 simply gives the 1972/73 rate, which was available on a county basis. Column 2 gives the rate which was obtained by applying the 1972/73 rate to 1971/72 incomes and pro-rating upwards the tax figure thus obtained for each county so as to make the total of county liabilities equal to the actual 1971/72 tax liability for England as a whole. Unfortunately, this method takes no account of changes in the distribution of incomes from one area to another during the years in question. On balance the second, higher, figures should be nearer actual rates, since the total county liabilities conform to the total liability for England but a check on the method (for Greater London, for which actual figures were available) showed that while the true average rate was 19.9 per cent, the 72/73 rate was 18.5 per cent and the 1971/72 pro-rated equivalent was 21.5 per cent. The estimates should therefore be treated with considerable caution.
3. Domestic rate receipts were not readily available on a county basis and had to be derived from '*Rates and Rateable Values in England and Wales*' and the companion publications for Scotland and N. Ireland. Total Rateable Value for the various county boroughs in say, Lancashire, had to be added to the TRV for the administrative county of Lancashire to give the county total. The same operation had to be carried out for numbers, for Domestic RV and for the Rate Call (Receipts). Domestic rate receipts were then derived by the formula.

$$\text{Rate call} \times \frac{\text{Domestic RV}}{\text{Total RV}} - \text{Domestic Element}$$

The Domestic element for 1971/72 was 9.5p times the domestic rateable value.

Distribution of Burden

4. Rate receipts for England for 1971/72 were £1905 million, of which £807 million or 42 per cent represented domestic receipts. The comparative figure in Wales, Scotland and N. Ireland was 40 per cent. On an English county basis there was very considerable variation. In the Greater London area with a population of 7.6 million, domestic receipts amounted to only 36 per cent of the total while in Sussex (population 1.24 million) the figure was 59 per cent. In Yorkshire (population 4.6 million) the comparable figure was 41 per cent, in Lancashire (population 5.3 million) 43 per cent. In general, those areas where domestic rate receipts form a lower percentage of total rate call require a lower addition to the average rate of tax.

5. The addition to average rate required is arrived at by simply treating domestic rate receipts as personal tax and dividing that amount by the amount of total net income. The addition to actual rates of tax would be much different. On the assumption that the additional tax required would be raised by means of an additional levy on the standard rate of tax (for 1971/72), the final column in the table gives the product of a 1p tax on all taxable incomes. Under the heading "Addition Required" column (a) gives the addition to the average rate, column (b) the addition to the standard rate.

6. The change in income tax burden from a switch of domestic rating with direct income taxation would vary considerably around the country. On 1971/72 figures, Sussex would face an 8.05p addition to the standard rate of tax and have the highest average rate (at 22.65 per cent to 25.75 per cent), even although that county did not carry the highest average rate to begin with. On the other hand, Durham with the lowest average rate to begin with and the second or third lowest after the switch, faces one of the highest additions to the standard rate of income tax at 8.57p.

7. It would be dangerous to draw conclusions from these projections but they are sufficient to indicate that to change from domestic rating to local income tax would have very considerable effects on the distribution of tax burdens.

ANNEX II B

PERSONAL TAX/DOMESTIC RATING

Increase in personal income tax rate required to raise same amount of revenue as domestic rating receipts for 1971/72

Numbers: Millions Amount: £ million

	Population	Total Net Income		Net Investment Income		Sch D - Profits and Professional Earnings		Domestic Rating	Average Personal Tax Rate	Addition Required		Total Average Tax Rate Required	Product of IP on IT Rate
		Nos.	Amount	Nos.	Amount	Nos.	Amount			(a)	Standard Rate (b)		
United Kingdom	55.7	21.0	35,600	4.9	2,120	1.8	2,698	954	17.9	2.68	6.13	20.58	155.6
England ..	46.3	17.8	30,603	4.2	1,845	1.5	2,260	807	18.0	2.64	5.88	20.64	134.9
Wales ..	2.7	1.0	1,517	0.2	72	0.1	133	37	16.3	2.44	5.83	18.74	6.2
Scotland ..	5.2	1.7	2,786	0.4	171	0.1	231	99	17.0	3.55	8.46	20.55	11.7
N. Ireland ..	1.5	0.5	694	0.1	32	0.1	74	11	16.1	1.59	3.83	17.69	2.8

Numbers: Millions Amount: £ million

ANNEX II B continued

	Population	Total Net Income		Net Investment Income		Sch D - Profits and Professional Earnings		Domestic Rating		Average Personal Tax Rate		Addition Required	Total Average Tax Rate Required		Profit of IP on IT Rate	
												Average Rate	Standard Rate			
		Nos.	Amount	Nos.	Amount	Nos.	Amount	Nos.	Amount	%	%	(a)	(b)	1+(a)	2+(a)	£m
Greater London	7.6	3.3	6,042	0.7	342	0.3	502	2.5	186	18.5	21.5	3.08	5.94	21.58	24.58	31.3
Bedfordshire	0.5	0.2	355	0.04	17	0.01	21	0.1	10	16.1	18.6	2.82	6.67	18.92	21.42	1.5
Berkshire	0.6	0.3	485	0.05	29	0.02	33	0.2	13	17.1	20.0	2.68	5.91	19.78	22.68	2.2
Buckinghamshire	0.6	0.2	406	0.03	24	0.02	27	0.2	13	17.8	20.7	3.20	7.22	21.00	23.90	1.8
Cambridgeshire	0.3	0.1	178	0.03	12	0.02	20	0.1	5	16.1	18.5	2.81	7.14	18.91	21.31	0.7
Cheshire	1.4	0.6	1,007	0.1	57	0.04	64	0.5	24	16.1	18.8	2.38	5.45	18.48	21.18	4.4
Cornwall	0.4	0.1	206	0.05	23	0.02	32	0.1	5	15.6	18.0	2.43	6.25	18.03	20.43	0.8
Cumberland	0.3	0.1	171	0.03	12	0.01	17	0.1	4	15.1	17.5	2.34	5.00	17.44	19.84	0.8
Derbyshire	0.9	0.3	488	0.07	22	0.03	36	0.3	12	14.0	16.4	2.46	6.67	16.46	18.86	1.8
Devon	0.9	0.3	475	0.1	59	0.04	53	0.3	14	15.8	18.3	2.95	6.67	18.75	21.25	2.1
Dorset	0.4	0.1	206	0.04	28	0.02	22	0.1	7	17.9	20.9	3.40	6.36	21.30	24.30	1.1
Durham	1.8	0.5	713	0.1	23	0.03	43	0.6	24	13.3	15.4	3.37	8.57	16.67	18.77	2.8
Easex	1.4	0.5	886	0.1	41	0.04	67	0.5	25	16.2	18.9	2.82	6.76	19.02	21.72	3.7
Gloucestershire	1.1	0.4	684	0.1	44	0.03	52	0.3	18	16.0	18.6	2.63	5.63	18.63	21.23	3.2
Hampshire and Isle of Wight	1.6	0.6	1,025	0.2	92	0.06	74	0.5	32	16.4	19.1	3.12	7.27	19.52	22.22	4.4
Herefordshire	0.1	0.06	107	0.02	9	0.01	9	0.05	2	17.5	20.6	1.87	4.00	19.37	22.47	0.5
Hertfordshire	0.9	0.4	762	0.08	439	0.03	41	0.3	20	17.9	20.9	2.62	5.55	20.52	23.52	3.6
Huntingdonshire	0.2	0.06	111	0.01	5	0.01	14	0.07	3	15.4	18.0	2.70	5.00	18.10	20.70	0.6
Total	1.4	0.3	812	0.1	59	0.04	56	0.5	26	16.6	19.3	3.20	6.67	19.80	22.50	3.9

Numbers: Millions Amount: £ million

ANNEX II B continued

	Population	Total Net Income		Net Investment Income		Sch D - Profits and Professional Earnings		Domestic Rating		Average Personal Tax Rate		Addition Required	Total Average Tax Rate Required	Profit of 1p on IT Rate		
												Average Rate	Standard Rate			
		Nos.	Amount	Nos.	Amount	Nos.	Amount	Nos.	Amount	%	%	(a)	(b)	%	%	£m
Lancashire	5.3	1.8	2,903	0.4	141	0.2	215	1.8	76	14.3	16.6	2.62	6.39	16.92	19.22	11.9
Leicestershire/ Rutland ..	0.8	0.3	510	0.07	30	0.02	36	0.3	12	15.8	18.4	2.35	5.71	18.15	20.75	2.1
Lincolnshire ..	0.8	0.3	454	0.06	21	0.04	46	0.3	16	15.9	18.5	3.52	8.89	19.42	22.02	1.8
Norfolk ..	0.6	0.2	356	0.06	23	0.02	32	0.3	8	14.9	17.4	2.25	5.00	17.15	19.65	1.6
Northamptonshire	0.4	0.2	296	0.04	14	0.02	24	0.1	8	16.1	18.9	2.70	6.15	18.80	21.60	1.3
Northumberland	0.8	0.3	442	0.06	23	0.02	33	0.3	14	15.3	17.9	3.17	7.00	18.47	21.07	2.0
Nottinghamshire	1.0	0.4	641	0.08	26	0.03	39	0.3	12	14.0	16.2	1.87	5.22	15.87	18.07	2.3
Oxfordshire ..	0.4	0.2	313	0.05	24	0.01	17	0.1	6	19.4	22.7	1.92	5.00	21.32	24.62	1.2
Shropshire ..	0.3	0.1	180	0.3	16	0.01	19	0.1	5	15.6	18.3	2.78	5.55	18.38	21.08	0.9
Somerset ..	0.7	0.2	347	0.07	33	0.03	39	0.2	11	16.2	19.0	3.17	6.11	19.37	22.17	1.8
Staffordshire ..	1.9	0.6	1,049	0.1	38	0.05	70	0.6	26	14.3	16.7	2.48	6.05	16.78	19.18	4.3
Suffolk	0.5	0.2	276	0.06	26	0.02	32	0.1	8	16.4	19.2	2.90	5.71	19.30	22.10	1.4
Surrey	1.0	0.4	828	0.1	77	0.04	50	0.3	26	19.2	22.3	3.14	6.19	22.34	25.44	4.2
Sussex	1.2	0.5	879	0.2	133	0.05	70	0.4	33	18.9	22.0	3.75	8.05	22.65	25.75	4.1
Warwickshire ..	2.1	0.9	1,606	0.2	60	0.05	87	0.6	36	16.2	18.7	2.24	5.37	18.44	20.94	6.7
Westmoreland ..	0.1	0.03	48	0.01	5	0.01	7	0.03	1	16.3	18.7	2.08	5.00	18.38	20.78	0.2
Wiltshire ..	0.5	0.2	299	0.04	19	0.02	27	0.1	6	16.2	18.7	2.01	4.29	18.21	20.71	0.4
Worcestershire	0.6	0.3	439	0.06	25	0.02	31	0.2	11	15.7	18.2	2.51	6.47	18.21	20.71	1.7
Yorkshire (East, North and West Riding)	4.6	1.8	2,817	0.4	150	0.1	201	1.6	57	14.8	17.3	2.02	4.83	16.82	19.32	11.8

INTERNATIONAL COMPARISON OF GOVERNMENT REVENUES

1. The table presents in as consistent a way as possible the breakdown of taxes received by central and by local government. It shows for each country and for a number of years revenue (taxes including social security contributions) received by all levels of government as a percentage of, and tax receipts as a percentage of gross domestic product at factor cost; taxes received by local government as a percentage of tax receipts and direct taxes received by local government as a percentage of tax receipts.
2. The source used is the National Accounts of OECD countries 1961-1972. For Denmark, however, the tax and social security figures are taken from the European Communities 1973 Tax Statistics - converted from a fiscal to a calendar year basis by straightforward time apportionment. France in the OECD publication combines direct taxes and social security contributions and so the latter are again taken from the European Communities statistics to obtain the figure for tax receipts. For Australia the 1972-73 figures are taken from the Australian National Accounts 1972-73 and for Switzerland the 1971 figures are taken from its yearly handbook of statistics. In the OECD publication tax receipts and social security contributions are given for general and central government - receipts of local government (i.e. all levels below central government) are taken to be the difference.
3. The reservations that are usually given with any international comparisons are applicable. Firstly two systems of classification are used, the former and the present SNA, and strictly countries falling in different groups should not be compared (former SNA - Belgium, Finland, France, Germany, Italy, Japan, Switzerland, USA; present SNA - Australia, Canada, Netherlands, Norway, Sweden, United Kingdom, Denmark - as explained in 2 above). Under these classifications non-recurrent levies on capital, such as gift taxes and death duties are excluded (although USA include these), but under the present SNA a tax on capital gains is treated as a tax on income. There are a few countries where these taxes do constitute a part, though usually less than about 3 per cent, of the local government revenue. A more detailed definition of taxes is given below. Local taxes are calculated by taking the difference between the general government tax receipts and those of central government (taxes are allocated to the particular level of government which is the final recipient). Although this procedure will put an upper limit on the local tax receipts, taxes going to other sectors of general government which generally would not be thought to be part of local government will be included - for example

indirect taxes received by small-scale government monopolies – but these amounts are unlikely to be significant. In considering the figures the different economic and political set-up in each country should also be borne in mind. For these reasons and others, the figures can be regarded as providing only a very broad indication of the relative weight of taxation in the countries shown, and the split between the tax receipts of central and local government.

4. Definitions (taken from *A System of National Accounts – UN 1968*). *General Government*: all departments, offices, organisations and other bodies which are agencies or instruments of the central, state or local public authorities, whether accounted for, or financed in, ordinary or extraordinary budgets or extra-budgetary funds. Included are non-profit institutions which, while not an integral part of a government, are wholly or mainly financed and controlled by public authorities or primarily serve government bodies; all social security arrangements for large sections of the population imposed, controlled or financed by a government; and government enterprises which mainly produce goods and services for government itself or primarily sell goods and services to the public on a small scale. Excluded are other government enterprises and public corporations.

The institutional sector for general government is divided into the following sub-sectors reflecting the differing roles in an economy of the various organs of government: (i) central government, (ii) local government, and (iii) social security funds. *Local Government* includes all agencies and instruments of state or provincial, district or county, municipal, town or village or other organs of government except the central public authority and the social security fund.

Direct Taxes. Include: levies by public authorities at regular intervals, except social security contributions, on income (which includes capital gains under the present SNA); levies at regular intervals on the financial assets and the net, or total, worth of enterprises, private non-profit institutions and households; and on the possession, or use, of goods by individuals and households (under the present SNA this includes motor vehicle licence duties which previously were an indirect tax). Real estate, land and property taxes are only included if they are in effect a tax on income.

Indirect taxes. Include: taxes on producers in respect of the production, sale, purchase or use of goods and services which they charge to the expenses of production; import duties; the operating surplus, reduced by the normal margin of profits of business units, of fiscal and similar monopolies of government; levies on owners or occupiers of real property.

ANNEX III

INTERNATIONAL COMPARISON OF GOVERNMENT REVENUES

	Total Revenue as a % of GDP at factor cost	Total Taxes as a % of GDP at factor cost	Total Local Taxes as a % of Total Taxes	Total Direct Local Taxes as a % of Total Taxes		Total Revenue as a % of GDP at factor cost	Total Taxes as a % of GDP at factor cost	Total Local Taxes as a % of Total Taxes	Total Direct Local Taxes as a % of Total Taxes		Total Revenue as a % of GDP at factor cost	Total Taxes as a % of GDP at factor cost	Total Local Taxes as a % of Total Taxes	Total Direct Local Taxes as a % of Total Taxes	
<i>Australia</i>															
1969/70	27.4	27.4	14.8	0		France	1969	41.1	26.4	17.5	3.3	Norway	1969	45.7	35.1
1970/71	27.9	27.9	13.9	0		1970	39.9	25.3	17.9	3.2	1970	47.6	36.9	31.3	
1971/72	29.0	29.0	16.6	0		1971	39.3	24.5	18.8	3.2	1971	51.7	39.1	29.0	
1972/73	28.0	28.0	18.9	0		1972	39.5	24.6	18.4	3.9	1972	53.5	39.4	28.3	
<i>Belgium</i>						<i>Germany</i>	1969	41.4	28.9	46.7	27.1	Sweden	1969	45.3	36.4
1969	37.8	27.0	6.9	5.1		1970	39.9	27.0	45.9	24.4	1970	45.3	36.7	35.1	
1970	38.6	27.1	6.8	5.1		1971	41.1	27.6	46.3	25.1	1971	49.4	39.8	31.4	
1971	39.7	27.5	6.8	5.1		1972	41.9	27.8	50.1	26.9	1972	50.4	40.4	32.0	
1972	39.8	27.5	7.2	5.5		<i>Italy</i>	1969	33.3	21.3	10.9	6.5	Switzerland	1969	26.1	19.9
<i>Canada</i>						1970	33.0	20.3	10.8	6.3	1970*	—	—	53.8	
1969	35.6	32.3	46.3	13.5		1971	33.7	20.4	10.3	5.9	1971	26.7	20.1	55.3	
1970	35.7	32.4	47.1	14.2		1972	34.1	20.6	12.6	6.7	1972*	—	—	49.5	
1971	36.2	33.1	47.0	15.3		<i>Japan</i>	1969	20.4	16.7	33.7	10.2	United Kingdom	1969	42.3	36.5
1972	36.7	33.5	46.8	15.6		1970	21.3	17.3	33.6	10.7	1970	43.9	37.7	11.7	
<i>Denmark</i>						1971	21.8	17.7	34.4	11.1	1971	41.3	35.4	11.3	
1969	39.8	37.7	21.8	17.4		1972	21.9	17.6	34.4	11.8	1972	39.4	33.1	0	
1970	46.1	44.0	21.8	17.3		<i>Netherlands</i>	1969	43.2	27.4	1.9	0	<i>U.S.A.</i>	1969	34.2	27.8
1971	49.5	47.3	26.1	21.7		1970	44.4	28.0	1.8	0	1970	32.9	26.5	9.0	
1972	49.7	47.5	27.5	23.5		1971	46.9	29.5	1.7	0	1971	32.2	25.8	10.1	
<i>Finland</i>						1972	47.8	30.3	1.7	0	1972	33.8	26.9	44.7	
1969	35.7	31.1	27.5	27.4										12.0	
1970	36.3	31.4	28.4	28.3											
1971	38.2	32.9	28.3	28.2											
1972	38.9	33.6	27.6	27.5											

Source National Accounts of OECD Countries 1961-1972

* No information

Notes 1. Total revenue of general government comprises tax receipts and social security contributions.

2. Local government includes all levels below central government.

ANNEX IV

INTERNATIONAL COMPARISON -
TIERS OF GOVERNMENT AND DIRECT¹ TAXES LEVIED

Country	Tiers of Government in Receipt of Tax Revenue	Taxes Levied by or for the Subdivisions
EUROPE		
BELGIUM	i. Central Government ii. Provinces (9) iii. "Urban centres" or "Associations of communes" (Agglomérations, Federa- tions de Communes) iv. Local authorities (2,500) (Communes)	ii. Surcharge on advance payments of national income tax on real property income. iii. (a) Surcharge on advance payments of national income tax on real property income. (b) Surcharge on the national income tax on individuals. iv. As iii.
DENMARK	i. Central Government ii. Counties (14) (Amtskarmuner) iiia. Copenhagen and Frederiksberg iii. Local authorities (277) (Kommuner – former municipalities and urban/rural districts)	} Income tax and real property tax.
FINLAND	i. Central Government ii. Provinces (11) (Läänit) iiia. Autonomous County (1) (Åland Islands) iii. Urban and rural local authorities (500) (Kaupungit or kauppalat and maalaiskuntat)	ii. No tax revenue of their own. iiia. Income tax. iii. Income tax, a very small estate duty.
FRANCE	i. Central Government ii. Regions (22) iii. Departments (90+) iiia. Metropolitan Paris iv. Local authorities (37,000+) (Communes)	ii. Very limited revenue of its own – functions mainly planning but now shares in iv's taxes. Land and real property tax, occupation tax, business licence tax (patents), registration duties. iii. Shares in iv's taxes.

¹ Including property taxes and other taxes which correspond to the taxes dealt with by the Inland Revenue in the United Kingdom. No account is taken of payroll taxes, motor vehicle licence duties and the like, the receipts of which at levels below the central government in certain countries may not be insignificant.

ANNEX IV continued

Country	Tiers of Government in Receipt of Tax Revenue	Taxes Levied by or for the Subdivisions
GERMANY	i. Federal Government ii. States (10) (Länder) iii. Local authorities (Gemeinden)	ii. Receives share of iii's taxes, and proceeds of various federal taxes; capital and transfer taxes. iii. Income tax on businesses, real property taxes.
ITALY	i. Central Government ii. Regions iii. Provinces iv. Local authorities (Comuni) v. Chambers of Commerce vi. Health, tourist, etc. administration (Azienda di Soggiorno, etc.)	Local income tax, part going to all these (vi only where found). Also tax on capital gains arising on disposals of real property, and tax on appreciation in value of real property companies' assets (levied for iv only).
THE NETHERLANDS	i. Central Government ii. Provinces (11) iii. Local authorities (1,000+) (Gemeenten)	ii. Surcharges on some of the local authority taxes. iii. Various real and personal property taxes.
NORWAY	i. Central Government ii. Counties (19) (Fylken) iii. Urban and rural (444) authorities (Kommuner)	ii. Shares in the taxes levied for the local authorities (iii below). iii. Income tax, urban real property tax, net wealth tax.
SWEDEN	i. Central Government ia. Provinces (25) (Landskap) iib. Counties (24) (Län) iii. Local authorities (Kommuner)	ia. No tax of its own, but the boundary usually coincides with that of a county. } Communal income tax.
SWITZERLAND	i. Federal Government ii. Cantons (25) (Kantone) iii. Local authorities (Gemeinden, Communes)	Income and wealth taxes, capital gains taxes on real and certain personal property, death and gift taxes.

ANNEX IV continued

Country	Tiers of Government in Receipt of Tax Revenue	Taxes Levied by or for the Subdivisions
CANADA	NORTH AMERICA	
	i. Federal Government (inc. NW and Yukon territories)	
	ii. Provinces (10)	ii. Income taxes (inc. mining and logging taxes), capital gains taxes, estate and gift taxes, business licence taxes, insurance premium taxes, paid-up capital taxes, taxes on transfer of land and securities.
	iii. Local authorities (there are several tiers: e.g. Ontario has regional municipalities, upper-tier and lower-tier municipalities, with great variation between the provinces)	iii. Real property taxes, business licence taxes.
USA	i. Federal Government	ii. Business licence taxes, income taxes, estate and gift taxes, stamp taxes, real and personal property taxes, insurance premium taxes.
	ii. States (50)	iii. Business licence taxes, real and personal property taxes.
	iii. Counties (3,000 +)	iv. Income taxes (in a few states), real and personal property taxes.
	iv. Local authorities (35,000 +) (City, town, etc., under many names, varying between states)	v. Income taxes (Pennsylvania), real and personal property taxes.
	v. School and special districts (53,000) (in some states these have elected bodies)	
NOTE: There is a great variation between states.		
		FAR EAST
AUSTRALIA	i. Federal Government (inc. Australian Capital Territory and Northern Territory)	ii. Estate and gift taxes, stamp duty, real property tax.
	ii. States (6)	iii. Real property taxes.
	iii. Municipalities (900 +) (four kinds.)	
JAPAN	i. Central Government	ii. Income taxes, real property acquisition tax.
	ii. Prefectures (47) (four kinds)	iii. Income taxes, various real and personal property taxes.
	iii. Municipalities, etc. (3,400) (four kinds)	

OVERSEAS COMPARISON - LOCAL DIRECT¹ TAXES

Country and political sub-divisions for which taxes are levied	Name of tax	Description	Rates of tax	Administration	Apportionment of charge	Relationship with other taxes
EUROPE BELGIUM <i>Taxes on Income & Profits</i> (i) Province; Urban centre or association of local authorities; Local authority.	Surcharge on the (national) advance payment of tax on income from real property (Centimes additionnels au précompte immobilier).	The advance payment applies to the "cadastral income" ² of Belgian real property of residents and non-residents.	Fixed annually by each of the authorities concerned; the national précompte rate of 3% may be increased to as much as 38% by "centimes additionnels".	By the central government; annual assessment usually made.	None necessary, tax is collected locally on behalf of the sub-divisions where the property is situated.	Credited, within limits, against the national income taxes; for real property used for business any tax not credited is deductible.
(ii) a. Urban centre; or b. Association of local authorities; c. Local authority.	Supplementary communal tax (Taxe communale additionnelle).	Surcharge on the assessed basic national income tax charged on most Belgian income of resident and non-resident individuals.	Fixed annually by each of the authorities subject to maxima laid down by income tax law, viz: a. & b. 1%; c. 5% where part of a. or b; d. 6% otherwise.	As for (i).	The proceeds are apportioned by the central government.	Cumulative with the national income taxes.
DENMARK <i>Taxes on Income & Profits</i> (i) County; Copenhagen and Frederiksberg.	County income tax (Amtskommunal indkomstskat).	Charged on the total net income of individuals resident in Denmark – less personal allowances – by the authority in whose area they are resident.	Rates are fixed annually by the appropriate authority; there is a very wide range with limits in 1974 as follows: Counties 4-7%; Copenhagen 19.7%; Frederiksberg 15%.	By the central government jointly with the national income tax; a form of PAYE operates but there is usually an annual assessment.	None necessary.	Cumulative with the national income taxes but the national and local income taxes and the national pension contributions cannot exceed 66½% of taxable income or 70% in the wealth tax is included (only the national income tax is abated).

¹ Including property taxes and other taxes which correspond to the taxes dealt with by the Inland Revenue in the United Kingdom.² Cadastral income is the registered net income as determined in periodic valuation, usually being less than the rent received.

continued over

ANNEX V continued

Country and political sub-divisions for which taxes are levied	Name of tax	Description	Rates of tax	Administration	Apportionment of charge	Relationship with other taxes
DENMARK (contd.) (ii) Local authority.	Communal income tax (Kommunalt indkomstskat).	As for (i) except also charged on real property, employment and business income, arising from Danish sources, of non-residents.	Rates are fixed annually by the authority; for 1974 the rates for residents are in the range 9.4-17.8% while for non-residents it is a flat 15%.	As for (i).	For non-residents by reference to the location of the real property, the permanent establishment of the business or the source of the wages or salary.	As for (i).

Note: 1. The receipts from the special income tax (saerlig indkomstskat) – a form of tax on capital gains – accrue to the central and local governments in the ratio 2:1.
 2. For corporation tax (selskabsskat) a fixed amount of 15% accrues to the local authorities.

Other Taxes (iii) Local authority.	Real property tax.	a. Levied on the owners of real property for which the appropriate valuation exists (post 1960 buildings are not taxed). b. Charged on the value of business premises.	a. The rate was fixed in 1960 – and is lowered every 4 years until the tax ends in 1990. b. The rate is fixed by the authority but must not exceed 1%.	Assessed and collected by the local authority in whose area the property is situated.	None necessary	Deductible for the national income tax.
(iv) County; Local Authority.	Land tax.	Charged on the value of land according to the latest official valuation (usually market value).	There is no limit on the rate levied by the local authority, the rate levied by the county cannot exceed 2%; for Copenhagen the rates vary from 0.6 to 5.5% depending on the value.	Assessed and collected by the local authority in whose area the land is situated.	None necessary.	As for (iii).

Note: 1. There is, if the owner pays no income tax, a further tax on land connected with farming, gardening etc., accruing to the local authority.

FINLAND <i>Taxes on Income & Profits</i> (i) Urban and rural authorities.	Communal income tax (Kunnallisvero).	Charged on the total income of resident individuals and companies except for real property and earned income arising abroad. Income includes gifts and inheritances, other than from close relatives, and owner-	Rates are fixed by the local authorities annually but there are no fixed ranges. For 1974 the average is 15% (Helsinki – 14%). There is relief for those on small incomes.	Usually by the local authority to which the tax is due and is generally separate from the national income tax. There are no special rules for non-residents. There	The tax accrues to the local authority where the taxpayer resides except that tax on real property income goes to the authority in whose area the property is and tax on	Cumulative with the national income tax. For residents the local and national income taxes and social security contributions must not exceed 90% of taxable income (only
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ANNEX V continued

Country and political sub-divisions for which taxes are levied	Name of tax	Description	Rates of tax	Administration	Apportionment of charge	Relationship with other taxes
FINLAND (contd)		occupiers are presumed to have a minimum income from their property. Charged on almost all the Finnish income of non-residents.		is a withholding tax but an annual assessment is usually made.	business income goes to the authorities in whose area the permanent establishments are. Special rules apply to non-residents and head offices.	the national tax is abated.
<i>Other Taxes</i> (ii) Urban and rural authorities.	The poor's percentage.	Charged on the gross assets of a deceased's estate.	1% of the value.	Computed by the executors and paid to the treasurer of the authority where the deceased lived, for poor relief.	None necessary.	
FRANCE <i>Other Taxes</i> (i) Departments and local authorities.	The business licence tax (Contribution des patentés).	Levied on all persons carrying on any business within the authority's area; most professions are included with exemptions for farming. The tax base is determined by the nature of the business, the population of the authority, the number of persons employed in the establishment and the rental value of the premises and plant.	The rate varies widely from authority to authority; relief is sometimes given to certain businesses to encourage local building.	The tax is administered and collected by the national tax administration.	None necessary.	Deductible as a business expense for income taxes.
(ii) Departments and local authorities.	Taxes on land and real property (Taxes foncières sur les propriétés bâties et non bâties).	Levied on the owners of land and/or buildings. The tax base is the rental value as at 1 Jan. 1970 (or at 1 Jan. each year for subsequent improvements).	The rates are fixed by the authorities.	Administered and collected by the national tax administration.	None necessary.	Deductible as a business expense for income taxes.
(iii) Departments and local authorities.	Occupation tax (Taxe d'habitation).	Levied on the occupiers of private premises. The tax base is the rental value with personal deductions and reliefs e.g. for old age.	As for (ii).	As for (ii).	None necessary.	Not liable if liable to the business licence tax. Levied on occupiers even if also liable to the property tax in (ii). <i>continued over</i>

ANNEX V continued

Country and political sub-divisions for which taxes are levied	Name of tax	Description	Rates of tax	Administration	Apportionment of charge	Relationship with other taxes
FRANCE (contd.) (iv) Departments and local authorities.	Registration duties (Droits d'enregistrement).	Charged on sales of immovable property and businesses based on sale price.	In addition to the state duty of 13.8% there is duty of 1.6% for the departments and 1.2% for the local authorities.	As for (ii).	None necessary.	Deductible for income taxes only if revenue transaction.

Note: The Regions are entitled to levy an annual surcharge on the taxes (i), (ii) and (iii).

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GERMANY (Federal Republic) <i>Taxes on Income & Profits</i> (i) Local authority.	Business tax (Gewerbesteuer).	Levied on every person or organisation engaged in business with a permanent establishment in Germany. The tax base is: (a) the taxable German income as determined for the corporation income tax or in the case of individuals the taxable business income as determined for federal income tax with some minor alterations; and (b) the business capital including long term debts (the tax may at the local authority's discretion be charged on a payroll basis in addition to the above).	The basic rates, fixed by federal law, are: (a) a maximum of 5% on profits (corporations are always charged this); (b) 0.2% of taxable capital. Each local authority then multiplies the sum of the two resulting taxes by a factor usually in the range 2½ to 3.	Administered separately from the federal income taxes but by the same Land Tax Office (Finanzamter).	By reference to payroll or in the case of retailers by reference to payroll and receipts or by other appropriate means. The total tax on German business income computed at the basic rate is apportioned between the local authorities in whose area the business operates, before the factors are applied.	Deductible for the federal income taxes and hence partially for itself, since the federal taxable business income is the starting point for this tax. The real property tax is partially deductible.
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Note: 1. 40 to 50% of the business tax is passed on to the states or to the Federal Government.

2. The receipts of the individual and corporate income taxes are shared between the Federal Government, the States and local authorities. The legal provision is that after making due allowance for local authorities' needs, the remainder of the revenue is shared equally between the Federal and the state governments. The present split is about 43% Federal, 43% states, 14% local authorities. The allocation of the taxes to a state is in proportion to the total income taxes collected by it.

ANNEX V continued

Country and political sub-divisions for which taxes are levied	Name of tax	Description	Rates of tax	Administration	Apportionment of charge	Relationship with other taxes
GERMANY (contd.)						
<i>Other Taxes</i> (ii) State.	Wealth tax (Vermögensteuer).	Levied on resident individuals and companies, and non-resident individuals and companies with assets in the state. The tax base is the total worth of the chargeable assets less debts and, in the case of resident individuals, various personal deductions.	Individuals: 0.7% of taxable wealth fixed by federal law. Companies: 1% of taxable wealth fixed by federal law. Non-residents and companies are not charged if wealth is below a certain minimum.	By the Regional Office of the state where the individual is resident or the main office is. There are special rules for non-residents.	Not usually necessary.	Not now deductible for the income taxes. There is relief for those who have to pay the capital levy under the Equalisation of Burdens law.
(iii) State.	Capital transfer taxes (Erbshaft-und Schenkungssteuern).	Levied on donees and trustees and charged on the net value of assets transferred. There is a personal deduction if the donee is related. Gifts from the same donor are aggregated over a 10-year period.	The rates, fixed by federal law, vary from a 3-35% range for close relatives to 20-70% for other persons.	By the Regional Office of the state where the donee resides.	None necessary.	This tax exempts any chargeable asset from the real property transfer tax.
(iv) State; Local authorities.	The real property transfer tax (Grunderwerbsteuer).	The transferor and transferee are jointly and severally liable on the transfer of 'real property' as defined under civil law. It is charged on the consideration.	The basic rate fixed by federal law, is 3% (or 2% for certain companies). There are municipal additions but these cannot take the effective rate beyond 7%.	By the local office (under the administration of the state) where the transfer is registered.	None necessary.	Property liable to the inheritance and gift tax is exempt.
(v) State.	The fire protection tax (Feuerschutzsteuer).	Levied on fire insurance companies on the basis of the premiums collected.	The rates, fixed by federal law, are 4% to 12% according to the type of company.	By the state where the main office is.	None necessary.	—

continued over

ANNEX V continued

Country and political sub-divisions for which taxes are levied	Name of tax	Description	Rates of tax	Administration	Apportionment of charge	Relationship with other taxes
GERMANY (contd.) (vi) Local authority.	The real property tax (Grundsteuer).	Levied on the beneficial owner of real property located in the municipality.	The basic rate, fixed by federal law, is 0.35%, except for the following: a. farming or forestry land – 0.6%; b. one family houses below certain values – 0.26%; c. two family houses – 0.31%. The basic tax is multiplied by factors determined annually by the municipalities.	By the local finance office (under state administration) in whose area the property is.	The value is apportioned according to the valuation law or the state can determine its own method.	Partially deductible for the business tax and deductible for the federal income tax.
ITALY Taxes on Income & Profits (i) a. Local authority b. Province c. Region d. Chamber of Commerce e. Health, pleasure & tourist administration.	Local income tax (Imposta locale sui redditi).	Charged on certain Italian and foreign net income of residents and on certain Italian net income of non-residents. Employee and investment income are generally not charged.	Range of rates are set by law for political sub-divisions a-d with a fixed rate for e. a. 6-8½% b. 14-24% c. 1-2% d. 0.4-1.2% e. 0.5%; a-d fix rate annually.	Jointly with national income taxes by local authority tax offices. Separate assessment for local income taxes.	Basically taxpayer indicates apportionment in return. Place of apportionment is where income arises or where taxpayer resides, according to the category of income.	Cumulative with national income tax for companies. Deductible for national income tax for individuals.
(ii) Local authority.	Local authority tax on the increase in the value of real property (Imposta comunale sull' incremento di valore degli immobili).	Charged on the capital gains arising on the disposal of real property. Also charged every 10 years on the appreciation in value over that period of real property – owing companies.	Progressive and dependent on the extent of the capital gain or appreciation in value. There is a range of rates at each level of capital gain or appreciation set by the central government, and the local authority fixes a rate annually within that range.	By the local offices of the national deed registration service. The local authority is entitled to seek amendment of return.	The tax is levied where the real property is situated.	Deductible for national and local income taxes if the tax is on the capital gain.

ANNEX V continued

Country and political sub-divisions for which taxes are levied	Name of tax	Description	Rates of tax	Administration	Apportionment of charge	Relationship with other taxes
THE NETHERLANDS <i>Other Taxes</i> (i) Local authority.	Personal property and rental tax (<i>Personele belasting</i>).	Levied on residents using a building and on non-residents who use a building for more than $\frac{1}{2}$ of a year. Tax base is rental value of the property and market value of furniture with deductions for dependants.	The basic rate, fixed by the central government is 3.4% of the rental value and 1.5% of the furniture value. Local authorities fix a multiple of this rate.	Assessed and collected by the central government.	None necessary.	Deductible as a business expense for the national income tax.
(ii) Local authority.	Commuter tax (<i>Forenzenbelasting</i>).	Levied on individuals who spend more than 90 days or keep a dwelling available in a local authority other than their own. Tax base is usually rental value.	Fixed by the local authority.	Assessed and collected by the local authority.	None necessary.	—
(iii) Local authority.	Land tax (<i>Grondbelasting</i>).	Levied on persons owning or holding (in usufruct) land; tax base is 'cadastral income' from the land and/or buildings.	The basic rate is 6% for land without buildings and 4.86% with buildings. The local authorities fix a multiple of these rates.	Assessed and collected by the central government.	None necessary.	Deductible as a business expense for the national income tax.
(iv) Local authority.	Municipal tax on fire insurance.	Levied on owners of movable and immovable property (usually limited to buildings) even if not covered by fire insurance.	The rate fixed by the local authority is a percentage of the insurance premium or the insured value or the 'cadastral income'.	Assessed and collected by the local authority.	None necessary.	—

Note: 1. The provinces have power to levy surcharges on the personal property and rental tax and the land tax; the central government also levies a surcharge on the latter.

NORWAY <i>Taxes on Income & Profits</i> (i) Local authority (<i>Kommune</i>).	Communal income tax (<i>inntektskatt til kommunen</i>).	Charged on most Norwegian income and a proportion of certain foreign	A range (18.5% - 21.3%) is fixed by the National Communal Tax Laws.	Jointly with the national income tax, which is assessed on	Real property and business income generally charged by	Cumulative with all other income taxes and <i>continued over</i>
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ANNEX V continued

Country and political sub-divisions for which taxes are levied	Name of tax	Description	Rates of tax	Administration	Apportionment of charge	Relationship with other taxes
NORWAY (contd.)		income of residents and on some income (real property, earned) of non-residents. There are personal allowances for residents.	Each local authority is free to fix its rate annually within the range; nearly all levy the maximum.	the basis of the Communal Tax Law. There is a withholding tax from wages but an assessment is made annually	the local authority in whose area the real property or a permanent establishment of the business is situated. Other income is charged by the local authority in whose area the taxpayer resides. There are special rules for non-residents and in some cases for companies.	national pension contributions, the special levy to aid developing countries and the wealth taxes. The sum cannot exceed 90% of taxable income (only the national income and wealth taxes can be abated).
<p>Note: 1. The counties (fylken) share in the revenue from the communal income tax. 2. There is also an income tax levied by central government the proceeds of which are used to help local authorities with too small a revenue of their own, called the 'Mutual Community Aid Tax' ('Felleskatt') charged at 1.7% on the taxable income for the Communal income tax.</p>						
<i>Other Taxes</i> (ii) Local authority.	Communal wealth tax (Formuesskatt til kommunen).	Levied on individuals and non-resident companies. Residents are taxed on their net capital assets excluding fixed property abroad; non-residents on their net Norwegian capital. For individuals there is a personal deduction so long as the communal income tax is paid.	The central government fixes the range which is 0.4 to 1%. Most authorities levy the maximum.	Jointly with the communal income tax and national income tax through a system of local boards.	By reference to where the taxpayer resides or the main office is situated. Real property is taxed by the authority in whose area it is situated.	As for (i).
(iii) Local authority.	Real property tax (Eiendomsskatt).	(a) Levied on owners of real property by urban authorities. The basis of the assessment is the valuation undertaken every 10 years. (b) Rural authorities may levy a tax on the basis of Land Register values.	The rates may be between 0.2 and 0.7%. The rates vary from authority to authority.	By the local authorities.	None necessary.	Deductible for the national and communal income tax.

ANNEX V continued

Country and political sub-divisions for which taxes are levied	Name of tax	Description	Rates of tax	Administration	Apportionment of charge	Relationship with other taxes
SWEDEN <i>Taxes on Income & Profits</i> (i) County; Local authority.	Local income tax (Kommunal inkomstskatt).	Charged on the total net income of residents of Sweden and on certain Swedish income of non-residents. In effect national taxable income after the various deductions is the base. There is a minimum deemed income from real property.	No fixed range; the local authority determines the rate annually. The average for 1974 is 23.17% (14.85% for local authorities and 8.32% for counties).	Jointly with the national income tax which is administered largely by the province. There is a form of non-cumulative PAYE but the local tax office in whose area the taxpayer resides usually has to make an annual assessment.	(i) Real property income: revenue to the authority in whose area the property is situated. (ii) Business income: revenue to the authorities in whose area business has a permanent establishment. (iii) Other income: revenue to authority in whose area the taxpayer resides. Special rules may apply to non-residents of Sweden.	<i>Companies:</i> deductible in arriving at the national income tax. <i>Individuals:</i> cumulative with the national income and wealth taxes but the sum cannot exceed 80% of taxable income (85% of excess over S.Kr. 200,000). The local income tax is not abated.
SWITZERLAND (CANTON OF BERNE) <i>Taxes on Income & Profits</i> (i) (a) Canton.	Income tax (Einkommensteuer).	(a) Charged for residents on total net income (excluding capital gains and extra-cantonal business/real property income) less various personal allowances. Also charged on Berne real property/business income of non-residents of the canton.	Progressive scale 2-6½% fixed by cantonal law, increased by multiple fixed annually by canton - 1973 multiple 2.3.	By the canton.	For business income by reference to turnover generally; for manufacturing industry by reference to assets and payroll; special provisions for head offices. Separate branch accounts for commercial businesses may be used if available.	Cumulative with the federal income tax (Defence Tax).
	Income tax (Einkommensteuer).	(b) Charged on the cantonal chargeable income of residents of the local authority and on the local real property/business income of non-residents of the canton.	Progressive scale 2-6½%; increased by multiple fixed annually by local authority - 1973 Berne city multiple 2.4.	Optionally by the local authority or the canton.	As for (i) (a).	As for (i) (a).

continued over

ANNEX V continued

Country and political sub-divisions for which taxes are levied	Name of tax	Description	Rates of tax	Administration	Apportionment of charge	Relationship with other taxes
SWITZERLAND (contd.) (ii) Canton; Local authority.	Profits tax (Gewinnsteuer).	Charged on companies etc. on the same basis as for income tax.	Basic rate is one-half of ratio between taxable net profit and paid up capital and certain reserves; minimum basic rate is 2%; maximum is 5%; 1973 multiplies Canton 2.3, Berne City 2.4.	As for (i).	As for (i).	Cantonal and local authority taxes are deductible in arriving at taxable income for the Federal Defence Tax.
(iii) Canton; Local authority.	Tax on net profits of corporations (Ertragsteuer von Genossenschaften)					
(iv) Canton; Local authority.	Capital gains tax (Vermögensgewinnsteuer).	Charged on capital gains arising on disposals of Berne real property and of certain securities by residents.	Basic rates of income tax increased by 40% in principle; increased by cantonal and local authority multiples.	As for (i).	None necessary.	For individuals cumulative with all income taxes; for companies deductible for federal tax.
Other Taxes (v) Canton; Local authority.	Wealth tax (Vermögensteuer).	Charged on the total net wealth of resident individuals of the canton (less certain personal deductions) and on the assets in the canton of non-residents. Companies with establishment in the canton are charged on net worth.	The basic rate, fixed by cantonal law, is for individuals in the range 0.045-0.125% and for companies in the range 0.075-0.15%. 1973 multiple for both tiers 2.4.	The assessment is made by the local authority under cantonal law.	Tax on real property goes to the authority where it is located.	For individuals cumulative with the income taxes but for companies deductible for Federal Defence Tax.
(vi) Canton; Local authority.	Capital transfer taxes (Erbchafts- und Schenkungssteuern).	Levied on donees acquiring real property in the canton, and movable property if the donor is resident. Gifts from the same donor are aggregated over 5 years.	The basic rates vary from 1% to 20% according to the relationship of donor and donee. The basic rate is increased by various factors according to the amount chargeable.	Collected and assessed by the local authority where the real property is situated or the donor is resident. The local authority retains 20% of the tax.	None necessary.	—

Notes: 1. This is just an example of the taxes in one Swiss canton - there are 25 cantons. There are considerable variations between them in taxes and their names, rates and reliefs, etc. Some have taxes not found in Berne, most tend to have only a real property capital gains rather than a general capital gains tax but some may charge capital gains to income taxes, especially companies' gains. In many cantons the local authorities (Berne included) levy a real property tax and some also levy a real property transfer tax. About three cantons also collect stamp duties.

2. The apportionment principles are the same throughout Switzerland in practice. The Swiss Parliament has before it a bill for the avoidance of inter-cantonal double taxation which would for the first time make the detailed principles statutory.

ANNEX V continued

Country and political sub-divisions for which taxes are levied	Name of tax	Description	Rates of tax	Administration	Apportionment of charge	Relationship with other taxes
NORTH AMERICA CANADA (PROVINCE OF ONTARIO) <i>Taxes on Income & Profits</i>						
(i) Province.	Income tax.	A surcharge on the relevant part of the federal income tax of individuals levied by reference to: (a) the total net income of residents of Ontario (except for some business income earned in Canada outside Ontario); (b) part of the Ontario business income of other residents of Canada; (c) the Ontario business and employment income of non-residents of Canada.	30 1/2% of the federal tax. The rate is fixed periodically by the Province partially under federal rules.	By the central government jointly with the federal income tax. There is a withholding tax on wages but an annual return and assessment is necessary. For residents there is a tax credit system.	Business income apportioned to Ontario by reference to turnover and payroll.	Cumulative with the federal income tax. There is a partial credit for the logging tax (q.v.) and a deduction in arriving at the taxable income for the mining tax (q.v.).
(ii) Province.	Corporation income tax.	(a) Charged on the income earned or deemed to be earned in Ontario by a Canada-resident company having a permanent establishment there. (b) Charged on the Ontario business, real property and capital gains income of companies not resident in Canada.	12% (nominal) rate fixed by Province.	By the Province.	Business income apportioned on the basis of turnover and payroll within and outside Ontario.	10% of the chargeable income is credited against the federal corporation income tax. (Hence effective rate of this tax is 2%.) There is a partial credit for the logging tax and it is deductible for the mining tax.
(iii) Province.	Mining tax.	Charged on the net income from mining operations in Ontario of all persons where the profit exceeds \$50,000.	15% - rate fixed by Province (graduated 0-40% scale proposed by 1974 Budget).	By the Province (Ministry of National Resources).	By reference to proportion of ores etc. produced or treated in Ontario.	Deductible for federal and provincial income taxes.
(iv) Province.	Logging tax.	Effectively charged on the net income from Ontario logging operations.	10% - rate fixed by the Province.	By the Province.	By reference to logs cut, sale of standing timber and rights thereto inside and outside Ontario.	Partially credited against the federal and provincial income taxes.

continued over

ANNEX V continued

Country and political sub-divisions for which taxes are levied	Name of tax	Description	Rates of tax	Administration	Apportionment of charge	Relationship with other taxes
CANADA (contd.) (v) Province.	Land speculation tax.	Charged on capital gains arising on the disposal of real property in Ontario with certain exceptions.	50% of gain – fixed by Province (plus additional tax in some circumstances where non-residents acquire control of a property company).	By the Province.	None necessary.	—
Other Taxes (vi) Province.	Paid-up capital tax.	Levied on corporations with a permanent establishment in Ontario. Taxable capital includes reserves and indebtedness, less capital deemed to be employed outside the Province.	The rate, fixed by the Province, is 0.2% or 0.4% for banks; there is a minimum of \$30.	By the Province.	For corporations with a permanent establishment outside Ontario capital is apportioned by reference to turnover and payroll.	—
(vii) Province.	Land transfer tax.	Levied on conveyances of land. Usually payable by the transferor on the consideration.	0.3% if consideration is below \$35,000 otherwise 0.6%. If the conveyance is to a non-resident the rate is 20%.	By the Province, tax payable on registration.	None necessary.	—
(viii) Province.	Succession duties.	Payable by beneficiary by reference to value of estate and gifts within 5 years of death, amount allocable to Ontario, and consanguinity.	The rates, fixed by the Province, range from 10% to 58% for close relatives up to 35% to 70% for others.	By the Province.	—	—
(ix) Province.	Gift Tax.	Levied on the donor; charged on the aggregate value of all gifts made during the year if taxpayer is resident. For non-residents only Ontario real property is chargeable.	The rates, fixed by the Province, range from 15% to 50%.	By the Province.	None necessary.	—

ANNEX V continued

Country and political sub-divisions for which taxes are levied	Name of tax	Description	Rates of tax	Administration	Apportionment of charge	Relationship with other taxes
CANADA (contd.) (x) Municipalities.	Property tax.	Levied on owners of real property or in the case of business premises the occupier. Tax base is usually the market value, but sometimes a different base such as turnover is used.	The rate is fixed annually by the local authority and includes a school levy. The Province fixes the factor which determines the rate for businesses.	By the municipalities under provincial law. In areas where population is sparse the Province administers the tax.	None necessary.	Deductible as a business expense for the federal and hence for the provincial income tax. For resident individuals there is a property tax credit as part of the tax credit system.

Notes: 1. There is no "typical" Canadian province in relation to income and other taxes. Taxes and administration differ from province to province often considerably. Ontario has been selected as an example.
 2. The land speculation tax appears to be unique to Ontario.
 3. There are various fees paid by companies on incorporation and capital transactions.
 4. Insurance companies besides being liable to corporation tax are liable on their gross premiums at a rate of 2%.
 5. In several provinces the corporation tax is administered by the Federal Government jointly with the federal tax.
 6. The personal income tax in Quebec is quite separate from the federal income tax.
 7. Municipalities have power to charge business licence fees.

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USA

Nearly all states of the USA levy income and other taxes. Several states authorise their cities or other municipalities to levy income taxes. In at least one state, school districts (governed by an elected body and therefore a "political" subdivision) are also authorised by the state to levy income tax.

New York State and City have been selected because they are among the most populous and the most important and show most of the income tax features found in other states; also Pennsylvania because its school districts levy income taxes.

1. NEW YORK STATE Taxes on Income & Profits	(i) Personal income tax.	Charged on the total income of state residents and the state income of non-residents. There are various personal deductions and reliefs.	Slice scale of 2-15% fixed by the state.	By New York State. There is a withholding tax on wages.	Salaries apportioned according to number of working days in the state.	Deductible for federal income taxes. Certain New York City income taxes are deductible. For residents other state and local income taxes are credited within limits.
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ANNEX V continued

Country and political sub-divisions for which taxes are levied	Name of tax	Description	Rates of tax	Administration	Apportionment of charge	Relationship with other taxes
NEW YORK STATE (contd.)	(ii) Unincorporated business tax.	Charged on the state net income of any unincorporated business (not professions) less fixed deduction.	5½ % of taxable income with investment, etc. credits.	By New York State.	On basis in taxpayer's accounts; if none, or such basis not approved, on basis of property, payroll and turnover.	Deductible for federal income taxes. The similar New York City tax is deductible for this tax.
	(iii) Corporation franchise income tax.	Levied on corporations operating in the state. Charged on one of four bases whichever gives the most tax: a. state net business income; b. state business and investment capital; c. net income and salary bill; d. flat fee.	The rates, fixed by the state are: a. 9%; b. 0.16%; c. 9%; d. \$125.	By New York State.	On basis of property, turnover and payroll in the state, with special provisions for investment income.	Deductible for the federal income taxes. The New York City income taxes are deductible for this tax.
Other Taxes.	(iv) Estate tax.	Charged on the estate allocated to the state with deductions for charitable gifts and transfers to spouse. All real property in the state is chargeable and personal property if the deceased was resident.	Slice scale, fixed by the state of 2-21%; credits for gifts to relatives and life insurance proceeds.	By New York State.	None necessary.	There is credit for federal estate tax and for gift tax on prior transfers.
	(v) Gift tax.	Levied on donor of any asset if resident, or of real property located in the state. Charitable gifts are exempt.	75% of estate tax rates.	By New York State.	None necessary.	Allowed as a credit against the state estate tax.
	(vi) Insurance premiums tax.	Levied on insurance companies in addition to the franchise income tax and based on gross premiums relevant to the state, less certain deductions.	The rates fixed by the state range from 1% to 2.58%, according to type of company.	By New York State.	By reference to the insured property or risk being located or resident in the state.	—

ANNEX V continued

Country and political sub-divisions for which taxes are levied	Name of tax	Description	Rates of tax	Administration	Apportionment of charge	Relationship with other taxes
NEW YORK STATE (contd.)	(vii) Stock transfer tax.	Applies to the sale or transfer of stocks, etc. within the state.	2½c per share, or in the case of sales a variable amount up to \$350.	By New York State, payment by way of stamps.	None necessary.	—
	(viii) Real property transfer tax.	Levied upon the conveyance of real property.	0.11% of consideration.	As for (vii).	None necessary.	—

Notes: 1. Some corporations and institutions are taxed under different regimes for the corporation franchise income tax.
 2. There is a state tax on mortgages (½%) which is collected and retained by the county.
 3. Corporations pay varied fees to the state on incorporation, capital stock increases, etc.

2. NEW YORK CITY
Taxes on Income & Profits

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	(i) Personal income tax.	Charged on the total income of residents less various deductions.	Slice scale 0.7% - 3.5%, fixed by New York City.	By New York City. There is a withholding tax on wages but an annual assessment is necessary.	None necessary.	Deductible for federal income tax. Credit given for other state and city income taxes.
	(ii) Earnings tax on non-residents.	Charged on New York earnings (employed and self-employed) of non-residents of the City.	a. 0.45% of wages, etc. b. 0.65% of self-employed income.	New York City, there is a withholding tax on wages.	None for wages, etc.; for self-employment income, property, payroll and turnover in the City may be used.	Deductible for federal income tax; partly deductible for state income tax; also credited against other state income taxes.
	(iii) Unincorporated business tax.	Charged on the New York City net income of any unincorporated business, less standard deduction (professions are liable).	4% of net business income.	By New York City.	On basis of property, payroll and turnover.	Deductible for federal income taxes and for similar state tax; credited against other state income taxes.
	(iv) General corporation tax.	Basically the same as for the New York State corporation Franchise income tax (see above).	The rates are: a. 6.7%; b. 0.1%; c. 6.7%; d. \$25.	By New York City.	As for the New York State tax.	Deductible for the federal income tax and the state corporation tax. No other income taxes are deductible for this tax.

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ANNEX V continued

Country and political sub-divisions for which taxes are levied	Name of tax	Description	Rates of tax	Administration	Apportionment of charge	Relationship with other taxes
NEW YORK CITY (contd.) <i>Other Taxes</i>	(v) Occupancy taxes.	a. Levied on tenants using premises for commercial purposes based on net rental value. b. Levied on all occupants of premises.	a. Slice scale of 2½-7½%. b. Flat fee of \$2-\$12.	By New York City.	None necessary.	—
	(vi) Property tax.	Levied on owners of real property, based on market value, with various reliefs.	Rate fixed annually by New York City.	By New York City.	None necessary.	—
	(vii) Real property transfer tax.	Levied on conveyances of real property, based on consideration.	1%.	By New York City.	None necessary.	—

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Notes: 1. The property tax can be levied by all tiers of government from school district up to the state usually in one collection; New York State does not at present levy it.
 2. There is a New York City mortgage tax similar to the state tax.

3. PENNSYLVANIA STATE <i>Taxes on Income & Profits</i>	(i) Personal income income tax.	Charged on world-wide income from certain sources of residents and state income of non-residents.	2½% of taxable income, with credits for low incomes and dependants.	By Pennsylvania State; there is a withholding tax on wages.	By various regulations unless readily allocated.	Deductible for federal income taxes; credit is given for other state and local income taxes.
	(ii) Corporation net income tax.	Charged on the Pennsylvania income of corporations doing business in Pennsylvania.	9½% of taxable income.	Pennsylvania State.	Business income by reference to property, payroll and turnover in Pennsylvania. Other income by various formulae.	Deductible for federal income taxes.
<i>Other Taxes</i>	(iii) Franchise tax.	Charged on the Pennsylvania capital stock of corporations doing business in the state.	0.1% of taxable value.	Pennsylvania State.	On the basis of property, payroll and turnover.	—

ANNEX V continued

Country and political sub-divisions for which taxes are levied	Name of tax	Description	Rates of tax	Administration	Apportionment of charge	Relationship with other taxes
PENNSYLVANIA STATE (contd.)	(iv) Corporate loans tax.	Charged on the value of loans on which interest is paid by local corporations.	0.4 % of the value of the loan.	Pennsylvania State.	—	—
	(v) Inheritance tax.	Charged on estates of deceased persons with property in the state with reliefs for charities and close relatives.	6% for close relatives, otherwise 15%.	Pennsylvania State.	None necessary.	Credit is allowed for federal estate tax.
	(vi) Insurance premium tax.	Levied on insurance companies operating in the state on basis of gross premiums received.	2% of the value for most companies.	Pennsylvania State.	—	—
	(vii) Real property transfer tax.	Levied on persons transferring real property located in the state.	1% of the value.	By the state through issue of stamps.	None necessary.	—

Note: There are various fees paid to the state by corporations on incorporation and ancillary transactions.

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4. PHILADELPHIA CITY Taxes on Income & Profits	(i) Personal income tax.	Charged on all wages and salaries of residents of Philadelphia and on Philadelphia wages and salaries of non-residents. Similarly with business income.	3.31 % of net income.	City of Philadelphia. There is a withholding tax on wages.	Not known.	Deductible for federal income taxes. Creditable against Pennsylvania State income tax.
(ii) School district.	(ii) School district investment income tax.	Charged on investment (real property and tangible/intangible personal property) income of residents of the districts.	2% of net income.	City of Philadelphia.	Not known.	As for Philadelphia personal income tax.

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ANNEX V continued

Country and political sub-divisions for which taxes are levied	Name of tax	Description	Rates of tax	Administration	Apportionment of charge	Relationship with other taxes
PHILADELPHIA CITY (contd.) <i>Other Taxes</i>	(iii) Property tax.	Levied on owners of real property in the city on basis of market value with relief for the elderly.	Fixed by the city.	City of Philadelphia.	Not necessary.	—
(iv) County.	(iv) County personal property tax.	Charged on intangible personal property such as loans, shares, etc.	0.4% of the value.	By the county.	Not necessary.	—

Notes: 1. Pittsburgh School District levies a tax on the net earnings of residents at a rate of 1%.

2. Property taxes are levied separately at the county, city and school district levels (the City and County of Philadelphia are co-extensive).

ANNEX V continued

Country and political sub-divisions for which taxes are levied	Name of tax	Description	Rates of tax	Administration	Apportionment of charge	Relationship with other taxes
FAR EAST						
AUSTRALIA (VICTORIA) <i>Other Taxes</i>						
(i) State.	Probate duty.	Levied on estates of persons leaving real or personal property in Victoria or world wide if resident with reliefs for agriculture, charities, etc.	Progressive with a maximum effective rate of 26% for close relatives and 34% for others.	By the state.	Special rules for the apportionment of personal property.	Gift duty is credited against the tax which is deductible for the Commonwealth estate duty. There is a partial credit of other states' probate duty.
(ii) State.	Gift duty.	Levied on the donor if he or the donee is resident. Value of gifts is aggregated backwards and forwards over a period of 1½ years. Reliefs as for probate duty.	Progressive rates with a maximum effective rate of 22%.	By the state.	—	Credited for the state probate duty; stamp duty is credited against the tax.
(iii) State.	Land tax.	Levied on owners of land not used for agriculture on the estimated selling price as if no improvements had been made. Relief for old age and low income earners but absentees from Australia pay an extra 20%.	Progressive rates from 0.42% up to 3.21%.	By the state.	None necessary.	Deductible for income tax if less than \$300 but only for the principal residence.
(iv) Municipalities.	Rates.	Levied on owners or occupiers of property. The main tax base is the net annual value. The un-improved capital value may be used and there are provisions for gradual introduction of site values.	The rate is fixed annually by the authority but must be between 3% and 20%. Extra rates may be levied for special purposes.	By the municipalities under state supervision.	None necessary.	Deductible for income taxes (within certain limits for individuals).

Notes: 1. The taxes administered by the other states in Australia are similar to those detailed above.

2. Victoria also imposes, in common with other states, stamp duties on transactions such as leases, conveyances and gifts.

ANNEX V continued

Country and political sub-divisions for which taxes are levied	Name of tax	Description	Rates of tax	Administration	Apportionment of charge	Relationship with other taxes
JAPAN <i>Taxes on Income & Profits</i> (i) Prefectures.	Prefectural inhabitants tax.	Charged on the total net income of residents of the prefecture. There are personal reliefs for individuals.	<i>Individuals:</i> 2-4% scale on taxable income. <i>Companies:</i> 5.2-6.2% range - surcharge on national income tax. (Scale & range set by national law; actual company rate fixed locally.)	<i>Individuals:</i> Assessed and collected by the municipality; there is a withholding tax on wages. <i>Companies:</i> By prefecture.	For companies apportioned by reference to payroll.	Cumulative with all other income taxes. For individuals there is a ceiling on the national and local income taxes of 80% of taxable income, the local taxes being abated.
QV (ii) Prefectures.	Prefectural enterprise tax.	a. Charged on the net income of certain businesses of individuals. b. Charged on the total net Japanese income of companies.	<i>Individuals:</i> 3-5% depending on type of business. <i>Companies:</i> 12% on taxable income (rates set by national law).	<i>Individuals and Companies:</i> by prefecture, partly in concert with national tax administration.	<i>Individuals:</i> Generally not necessary. <i>Companies:</i> total tax apportioned generally by reference to payroll.	<i>Individuals:</i> Cumulative with all other income taxes. <i>Companies:</i> Deductible directly or indirectly for all other income taxes.
(iii) Municipalities.	Municipal inhabitants tax.	Levied on residents of the municipality on the same basis as (i).	<i>Individuals:</i> 2-14% scale on taxable income. <i>Companies:</i> 12.1-14.5% range - surcharge on national income tax. (Scale and range set by national law; there are at present certain surtaxes in Tokyo.)	By municipality for both companies and individuals; for the latter jointly with the prefectural inhabitants tax.	For companies apportioned by reference to payroll.	Cumulative with all other income taxes, but for individuals as in (i) above.
Other Taxes (iv) Prefectures.	Real property acquisition tax.	Levied on persons acquiring real property other than by inheritance.	3% of value, with relief for new buildings.	Prefecture makes the assessment.	None necessary.	Deductible for the special land-holding tax.

ANNEX V continued

Country and political sub-division for which taxes are levied	Name of tax	Description	Rates of tax	Administration	Apportionment of charge	Relationship with other taxes
JAPAN (contd.) (v) Municipalities.	Property tax.	Levied on owners of real property and certain business assets on basis of market value.	1.4-2.1% range fixed by national law; the municipality fixes the rate.	Assessed and collected by the municipality.	None necessary.	Deductible for the special land-holding tax.
(vi) Municipalities.	Special land holding tax.	Levied on landowners or persons acquiring land. Charged on basis of the previous year's market value.	Rates, fixed by national law, of 3% on acquisition, thereafter 1.4% p.a.	Self-assessed and paid to municipality.	None necessary.	The property and real property acquisition taxes are credited against this tax.

Notes: 1. Both prefectures and municipalities also levy '*per capita*' levies (poll taxes) on individuals and companies, but these are very small indeed.
 2. Municipalities also levy an additional property tax in planning areas and a land development tax.

Evidence by the Inland Revenue

SUPPLEMENTARY WRITTEN EVIDENCE

PAYE - EMPLOYERS' COSTS

1. It is not possible to give more than a very broad indication of employers' costs in operating a PAYE system modified to include LIT. The reference in paragraph 48 of the Board's evidence to a broadly one-to-one ratio between employer and Revenue costs in operating PAYE was based on a survey carried out by a management consultant during studies in 1971 which led up to the proposal for a tax credit system. The study, which was a fairly small-scale one, suggested that PAYE work at that time might require in employers' offices staff numbers of roughly the same order as were then employed on PAYE work within the Revenue. Since 1971 there has been further computerisation of payrolls which generally brings significant savings to employers on PAYE work.
2. Our survey did not bring out the proportion of employers' time spent on each aspect of PAYE work, so it is not possible to make any systematic evaluation of the relevance of these overall costs to the additional costs which might be incurred in adapting PAYE to collect LIT. Employers' costs might in any case be significantly affected by the precise details of the system adopted. For instance, administratively it would be cheapest to issue supplementary tax tables for calculating LIT. The employer would use the appropriate table to calculate the LIT due in each case, which would have to be added to the income tax due and then deducted from the employee's wages. Assuming such supplementary tables were constructed to cover every possible local authority tax rate, they would have an indefinite life; but this system would substantially add to the cost of weekly PAYE work, because the employer would have to refer twice to the tax tables, and do an addition in each case, before the tax deduction for any employee could be made.
3. A possible alternative, which would save much of this additional work, would be to issue tax tables in which income tax and LIT were aggregated, so that the employer would only have to look up one figure (as now) and would not have an addition to do: and the split between the Exchequer and the local authorities would be made by the Revenue after the end of the year. But this would require up to 10 times as many tax tables as now (assuming local authorities could levy LIT at up to 5p in the £ in steps of .5p) and they would need to be supplemented when income tax rates changed, as they have in the last 2 years. Apart from the very large cost of compiling, printing and distributing so many tables, this approach might well have to be ruled out because it would delay unacceptably the implementation of new tax rates for

PAYE following Budget changes in the rates of national income tax—in such circumstances the timetable for the distribution of the new tax tables is crucial.

4. This illustrates the difficulty of making any comparison without a fully worked out scheme. But our feeling is – and we should emphasise that it is no more than this – that taking into account the additional weekly and end-of-year work employers would probably have to do, plus the additional complications LIT would introduce into the PAYE system generally, which would inevitably give rise to time-consuming mistakes and employees' queries, additional employers' costs could well be broadly similar to ours. But there would be wide variations between employers. Those using payroll systems which were both fully computerised and also possessed sufficient spare capacity to take on the additional calculations might well have relatively small additional costs once the necessary programming and stationery changes had been introduced. On the other hand, the great bulk of employers using other systems, who probably employ the overwhelming majority of employers' staff engaged on PAYE work, would find the position very different. Probably the small and medium sized employers, whose PAYE performance at present tends on average to be below the standard of the large employer, would have the greatest difficulty in coping.

DETERMINATION OF RESIDENCE FOR LIT

1. Paragraphs 28(d) and 34 of our evidence dealing with the question of residence do not attempt to set out a possible residence test for LIT, but proceed on the basis that a definition of residence would have to be included in any legislation levying an LIT; it would clearly be insufficient to rely simply on the taxpayer's last known address.
2. For such a definition, it seems unlikely that the declared address on a particular date would be satisfactory. In many cases this would be regarded as being, on the one hand, inequitable (because, for example, the circumstances before or after the date on which that address was given were different) or, on the other, as giving scope for avoidance. Such a test would clearly be unsatisfactory for large classes of taxpayers such as those with more than one home, or mobile homes, people regularly travelling in their work, people living part of the year with their parents, or their children, people temporarily away from home through sickness, and people temporarily abroad such as seamen and the armed forces. In all such cases it might be necessary to look beyond the current address we happen to have, or the address at which the individual was living on a particular day. This suggests that the rule would have to be in terms of somebody's normal or habitual place of abode at a specific date. We do not think, however, that this – or any other – rule would avoid creating a hard core of awkward cases.
3. To return to the present position, so far as the existing PAYE system is concerned, we are only interested in addresses as a means of sending communications to employees. The postal addresses on our records may be several years out of date, but if we have any difficulty in communicating with an employee through the latest address we have we would normally write care of his current employer. So an up-to-date address, let alone knowledge of a taxpayer's 'residence', is not vital to the operation of PAYE.
4. For the reasons given above, any LIT could not operate satisfactorily on the basis of addresses which happen to come on to the Revenue's files. Indeed, to try to use our records might almost be an incentive for people to mislead us about their true addresses. While some of the information we receive in the course of a year about a taxpayer's address would be helpful in establishing his residence, e.g. notifications of building society interest paid, other information, such as the address from which a taxpayer happened to write to us about his tax affairs, might not necessarily be relevant. In

particular, the addresses given on forms P45 (the form handed in when an employee starts a new job) would often be misleading because the new employee would generally give his old address to his new employer unless he had already moved into new accommodation before he took up his new job. The P45 should be sent to us as soon as the new job starts, and there is no obligation on the employer or employee to send us any further information about subsequent changes of address. And, of course, the form P45 would remain unamended whenever the taxpayer changed his residence but not his job. Such would be the case also when employees moved, on their retirement, to a new home but stayed within their firm's occupational pension scheme.

5. The Committee suggested that taxpayers moving from a high rate area to one with a lower rate would, in their own interests, notify the Revenue. Some would, of course, let us know, but we doubt if the connection between residence and LIT rate would be so clearly in the taxpayer's mind when he has many other things to do on a change of residence that he would invariably remember to write to us—particularly as the change might have no effect on his tax deductions for a period of possibly up to 2 years, i.e. the start of the tax year for which his new residence for LIT purposes would take effect.¹ But the problem, as the Committee recognised, is people moving to areas levying a higher LIT rate. Unless we pick up such changes of residence, deductions for the following year will continue at the lower rate and there will then be an LIT underpayment which, when we become aware of it, would probably have to be collected through a formal assessment for that year.

6. As we are very far from having a complete picture of up-to-date addresses, and as a postal address by itself would in any case be an unsatisfactory basis on which to levy LIT, some system of formal notification of information on which to establish each taxpayer's residence position seems essential. Probably only in the case of the owner-occupier with a mortgage would it be possible to rely on an outside source of information giving us notice of a change likely to affect residence. Within the PAYE system the notification might be done by the employer, but it would entail operational problems for large employers with dispersed operations, and since an employer generally has no vital interest in his employees' addresses, he may not know of changes of address, and he will not have any means of checking on the accuracy of any information given to him. This suggests that a direct notification from the taxpayer to the Revenue would be necessary. It would not be satisfactory simply to lay an obligation on taxpayers to notify us of changes of residence. For the reasons already mentioned in paragraph 5, a large number of taxpayers would probably fail to let us know, and in the case of more technical changes of residence where there was not a clear household move, they would generally be unaware of the point. This means it would be particularly difficult to envisage any effective sanction against non-notification. The collection of any

¹ This is on the assumption that the residence position of each LIT payer for the coming tax year would be derived from the annual tax return, issued in April. It would in any event be necessary to settle the matter by the autumn before the tax year began, so that it could be taken into account in the PAYE recoding for the following year which generally starts in October.

extra tax will proceed in any case once we find out about the change later, and, even if the Government were prepared to take penalty powers, tribunals would be reluctant to enforce them for a possibly once-in-a-lifetime omission of this kind.

7. In practice, therefore, we would have to rely on an expanded tax return to give us the necessary information. The LIT residence section would add another section to a document already much criticised for its length and complexity. More important, however, at present some 12 million PAYE taxpayers do not receive a tax return every year, and this number will increase in future, so in these cases we would not have a regular flow of information about residence. If the right tax is to be collected year by year we would have to send either an ordinary tax return, or a special residence return to these people each year.

8. The Committee has also suggested that, once the initial setting up process was complete, it might be necessary to take account only of the two million or so household moves each year, and that for various reasons a substantial proportion of this group could be easily disposed of because either the move would be immaterial, or we would hear about it in some way in the normal course.

9. We doubt if the problems of changes of residence can be dealt with so easily. In the first place, we would be concerned with changes of residence, not household moves. It may be that many of the cases mentioned in paragraph 1 there may be a change of residence from one year to another even though there is no 'household move', so the former could considerably exceed the latter. Moreover, a single household may include two or more taxpayers so the number of taxpayers for whom we would have to take action would be correspondingly increased. Usually when the family moves there should be little difficulty in linking the husband's move with the records of his working wife, but this would be less easy with working children, if they also moved, because there would be no cross references. Moreover, if a change of residence involves a change of job, the husband's residence position for a year at least may be different from that of the rest of his family if he takes temporary accommodation near his new job before the rest of his family can move – assuming that the definition regarded such a move as relevant for LIT purposes. This suggests that the total number of taxpayers whose LIT residence status might need to be reviewed each year might significantly exceed the figure of 'household moves'.

10. The Committee suggested that we would be able to ignore a significant number of such changes. If a change was within the same local authority area it would certainly be irrelevant for LIT purposes. All other changes would call for some action by the taxing authority: even where the taxpayer moved from one area to another which levied LIT at the same rate, his records and PAYE code would need amendment, for in the following year the areas might impose a different rate of LIT. Similarly, with the non-PAYE case, we would still need to know of the change of residence so that the appropriate rate of tax could be taken into account when the next assessment was made;

and every change of address would need to be reviewed by the tax office to see whether any action needed to be taken.

Conclusion

11. As residence would be a factor which might significantly affect a taxpayer's overall liability in any year, it would not be good enough to leave the picking up of changes of residence to inferences made from other information which may or may not reach us. It seems clear that our existing sources of information do not cover the whole field of residence changes, and that even where they do provide some coverage (e.g. on forms P45 for new jobs) the information needed for evaluating residence changes would often not be given. Against this background, we see no satisfactory alternative to regular enquiries from the Revenue to all taxpayers about their LIT residence status.

REASONS FOR ABOLITION OF SCHEDULE A CHARGE ON OWNER-OCCUPIERS OF RESIDENTIAL PROPERTY

Form of the Old Schedule A Tax

1. The tax on owner-occupiers which was abolished by the Finance Act 1963 was part of a general system of taxing both real and imputed income from real property. Before the 1939-45 war the system was based entirely on quinquennial valuations. At the valuation an annual value was arrived at for each property, based on a market rent, and a percentage deduction was made to cover repairs etc. The tax was collected from the occupier; but he was entitled to deduct it when paying his rent, and any intermediate lessor who received rent net of tax was in turn entitled to deduct the tax in paying rent to his superior landlord. Thus the tax was ultimately borne by the owner when the property was owner-occupied, and by the ultimate landlord where it was tenanted. If for any reason the occupier was paying no rent, and therefore could not pass on the charge, it fell on him ('beneficial occupation'); and if he was paying a rent of less than the annual value and could therefore pass on only a part of the charge the remaining part fell on him.
2. If, as was the case when income tax was introduced, everyone had been paying tax at the standard rate, and only at the standard rate, the system would have been extremely simple since there would have been no need for the Revenue to know the identity of the occupier or landlord; the tax would have been collected at the standard rate on the property, leaving the incidence of the charge to settle itself as described above. If, however, the owner-occupier was not liable at the standard rate, or if the landlord on whom the charge ultimately fell was liable to surtax, it was necessary to know his identity and overall tax position so as to reduce the charge in the first case, and make a surtax assessment in the second. In practice, cases in the first category were proportionately not very numerous and did not seriously affect the simplicity of the system.
3. Because of the war, quinquennial valuations had to be postponed (see 4 below). As a supplement to the machinery described above, therefore, landlords were charged directly, from 1941, on the amount by which their rents exceeded the Schedule A assessment ("excess rents").

Background to Abolition of Charge on Owner-Occupiers

4. No general Schedule A revaluation was made after 1935-36, and annual values therefore continued to be based on rents current at that time. Hence they were far below current market value rents. With the transfer of rating

valuation to the Inland Revenue in 1948, and the imminence of a fresh rating revaluation which would throw up true current rental values for all properties, the question whether the existing out-of-date system could be allowed to continue—and, if not, how it could be altered—came to a head. Under the excess rents provisions landlords were taxed on their income, but for the growing number of owner-occupiers the crucial question was could they be called on to bear the very substantial additional tax which would result from revaluing properties for Schedule A purposes on the full current market rents?

Views of the Royal Commission

5. The arguments for and against the then Schedule A were considered by the Royal Commission on the Taxation of Profits and Income, and set out in paragraphs 824 to 828 of their Final Report. The argument against Schedule A was that notional income is not a fit subject for taxation. Of the arguments for Schedule A, the one which was most used in parliamentary debates was that the charge ensured that the owner-occupier did not have an advantage over the tenant, who had to pay his rent out of taxed income. The Commission concluded that the arguments in favour of a continued tax on owner-occupiers were still valid.

On the question of valuation, they seemed prepared to contemplate that the charge should be based on full current values but concluded that, for the time being, assessments based on 1939 values (which were about to be introduced for rating) would be a reasonable *quid pro quo* to the owner-occupier for the fact that the protected tenant was not charged on the beneficial occupation element in his tenancy.

The Decision to Abolish Schedule A Tax on Owner-Occupiers

6. The question of abolition was discussed on several occasions during the debates on Finance Bills before 1962; see, for example, the 1961 debates (Hansard, 20 June 1961, cols 1323/1394). The main argument put forward by the critics of Schedule A was that notional income should not be taxed. On this point the Chancellor of the Exchequer (Mr Selwyn Lloyd), while rejecting abolition for the present, said that he found the idea of notional income "somewhat difficult to explain and perhaps difficult to understand. I am prepared to admit that the idea of notional income is illogical" (col 1354). A further argument put forward by Mr Nabarro was that if *all* owner-occupiers made claims for maintenance costs in excess of the fixed allowance, instead of the 9 per cent who actually did so, the yield from the tax might be virtually eliminated.

7. In his 1962 Budget Statement, the Chancellor announced his decision to abolish the charge on owner-occupiers from the following year. His reasons were that if the tax was to continue it would have to be on the basis of realistic valuations ie current values, and that the additional tax burdens which this would impose on owner-occupiers would be excessive. (If assessments on out of date valuations had continued, it is likely that the yield would have fallen year by year, because of claims for excess maintenance costs.) Legislation to

abolish the charge was introduced in the 1963 Finance Bill. It was decided that since there would now be no *general* charge on all real property it would not be appropriate to continue to use the existing Schedule A mechanism for the purposes of taxing rents. The legislation therefore provided for rents to be assessed on the landlord, under Case VIII of Schedule D (subsequently renamed Schedule A as from 1970-71).

SCHEDULE A TAX AS A SUBSTITUTE FOR RATES

The Tax Base for a Schedule A Charge

8. The old Schedule A (up to 1963) was in principle a tax on the ownership of land and buildings, whether owner-occupied or let. Presumably a new Schedule A would be intended as a charge on the occupation of property – that is, on the benefits enjoyed by residents from local authority services – since if it were a charge on ownership it should also be borne by landlords of let property. If, however, it is to be a charge on occupation it could not be restricted to owner-occupiers but would have to extend to tenants.

How Should the Base of a Tax on Occupation be Measured?

9. In the past there was a separate Schedule B charge on the occupation of *land*; this was progressively reduced by the transfer of farming profits to Schedule D, and the abolition of the charge on amenity land; it now remains only for commercial woodlands for which an election to be taxed under Schedule D has not been made. The assessment for Schedule B was originally one-third of the Schedule A annual value for all lands, including farms, but the assessment on farm land was increased in stages to three times the annual value – until the charge was transferred to Schedule D. This historic Schedule B rule does not provide a satisfactory way of measuring the value of the occupation of a dwelling; a figure of one-third of the rental value would produce a quite inadequate tax base. It is difficult to see any sensible alternative to using the full rental value – in effect, the rating valuation – even though this was used under the old Schedule A as a measure of income from *ownership*. For a tax on the value of occupation, however, the deduction to be made for repairs would be fixed by reference to a tenant's liability for repairs; and since the gross rental would be based on the assumption that the landlord does the external and structural repairs, the deduction for tenant's repairs would be relatively small.

Rate of Charge

10. Once the tax base is settled it would have to be decided whether local authorities should have a discretion about the rate of charge. In order to produce a tax which was more progressive than the present rating system, it would be necessary to change from the present flat rate poundage, which is fixed by the local authority. If, however, the change took the form of adding the Schedule A assessment to the occupier's total income, and charging with reference to national tax rates, local authorities would have no control over the rate of charge and therefore over the yield. Moreover, the effect of charging by reference to total income would be to give a substantially higher tax rate to

prosperous areas than to poorer areas – in addition to the larger base (i.e. higher land values) which the more prosperous areas already enjoy. Not only, therefore, would the local authorities lose control of the yield but there would be a disparity between the rate receipt of the rich and the poor areas (though this might be compensated for by a change in the basis of the rate support grant).

11. On this approach the Schedule A tax attributable to the occupiers in a given local authority's area would be calculated by the Inland Revenue, and handed over to the local authority.

12. It might be suggested that to prevent local authorities from losing control over the yield, the tax should be calculated by using the national structure of total income and personal allowances but allowing each local authority to fix its own scale of graduated tax rates instead of using the national scale. This, however, would require the Inland Revenue either to disclose details of the total income and personal allowances to the local authority (which raises the question of confidentiality discussed in paragraph 10 of our March 1975 paper '*New Sources of Revenue: Local Direct Taxation*'); or to carry out the separate calculation on behalf of the local authority. It would also have serious implications for the equity of the system; existing criticisms of lower rate poundages for richer areas would be likely to increase sharply if the graduated scale of personal tax rates used for Schedule A were much more severe in poorer areas – as it would need to be.

Marginal and Average Tax Rates

13. If the Schedule A assessment were charged at the occupier's marginal national tax rate there would be no progression over a very large band of income. This is because the first £4,500 of a taxpayer's income, after deducting personal allowances, is charged at the basic rate (leaving aside the surcharge on investment income over £1,000). At the extreme, if two individuals, both married and with no children, both living in houses with a Schedule A assessment of £400, were earning respectively £1,000 and £5,000, they would both pay rates of £140 (ignoring any rebate scheme). This also means that the marginal rate is non-buoyant over the same long band; that is, even though the general level of incomes increases, individuals whose incomes rise from year to year within this band will not pay any increase in rates.

14. The alternative would be to charge the Schedule A tax at the average tax rate applicable to the occupier's income (apart from Schedule A). On this basis the first of the two individuals cited in 13 would have an average tax rate of 1.6 per cent and would pay rates of about £6. The second would have an average rate of about 28.3 per cent and would pay rates of about £113. The average rate would also ensure that if two individuals with the same incomes (and the same Schedule A assessments) had different personal allowances, the one with the larger allowances would pay lower rates, even though their marginal tax rates might be the same.

15. Whether the tax is charged at the marginal or average rate, it is bedevilled by the problem of the household with several earners. Under the national tax

system each individual has his or her own set of personal allowances and graduated rates.¹ The separate personal allowance extends to a married woman, as regards her earned income; though if she also wishes to claim a separate graduation scale from her husband's, he has to forgo his married allowance and receives instead the single person's allowance.

16. Assuming that all the earners in the household were in the same family, who should be treated as the occupier, i.e. whose individual tax rate should determine the rate of charge on the Schedule A assessment? Should it be the husband, or the wife in respect of her earnings, or one of the earning children? If it was decided that the tax rate of the individual who owned the house should be used, would there be any rule to prevent a high earning husband from reducing the liability if he transferred the house to his low earning wife, or to an earning child (though capital transfer tax might act as a deterrent in the latter case); and what would the rule be for a family in a rented house? Would there be a special rule, where a retired person on pension was living with a high earning son or daughter, to ensure that the son's or daughter's tax rate was used, regardless of who owned the house?

17. Even if it were practicable to provide that the average tax rate for the aggregate family income should be used, this would not produce a satisfactory result. Because of the separate set of personal allowances and graduated rates for each earner, the average tax rate for the aggregate income of a household where the wife, and perhaps one or more children, is earning as well as the husband, will be substantially lower than the average tax rate for many households where the husband alone is earning, even though his income is much less than the aggregate income of the whole family in the first case. If this was regarded as indefensible it would be necessary to invent a new system, quite distinct from the national tax rules, for dealing with aggregate family incomes, simply in order to arrive at a tax rate to be applied to the Schedule A assessment; and this might be felt to cast doubt on the equity of the existing tax rules in relation to family earnings.

18. Households with lodgers would also raise a problem. It might be argued that since the income from letting would form part of the householder's income, his average tax rate would be correspondingly increased and this would be sufficient to deal with the problem. This solution, however, would not necessarily produce an equitable sharing of the burden as between the single earner who was supporting his family and the household with one or two lodgers; nor, if a special rule were introduced for dealing with aggregate family earnings, between such a case and the household with lodgers.

19. In addition to the personal allowances there are certain general reliefs in the national tax structure which a person can set against his total income for

¹ In his March 1974 Budget the present Chancellor expressed his intention of reintroducing aggregation of the income of minor children with their parents' income; specific proposals have not yet been brought forward. Under the aggregation rules introduced by the previous Labour Government (and in force from 1969-70 to 1971-72), however, aggregation did not apply to earned income of the children (nor to investment income where the child was regularly working).

tax purposes – for example, a loss incurred in trade. It might be thought unacceptable for a householder to escape payment of rates in a particular year, or bear a substantially reduced rate burden, because he had a trading loss in that year which eliminated or substantially reduced his taxable income (and therefore eliminated or reduced his average tax rate). It might therefore be necessary to disallow these general reliefs in computing the tax rate for Schedule A purposes; this would represent a further variation from the normal rules.

20. Similarly, in the national tax system, relief is allowed against a taxpayer's general income for interest paid on a loan to buy his house (up to £25,000), and for certain other purposes. This reduces his national average tax rate and would presumably be regarded as putting him at an unfair advantage in this respect compared with the tenant occupier. The same applies to tax relief for premiums paid on a house purchase life assurance policy. In short, it might be necessary to provide that in calculating the average tax rate (or the marginal rate if that were to be used) the only allowances to be given should be the personal allowances. This would entail a notional tax computation, quite different from the actual tax computation, in a very large number of cases.

Staff Requirements

21. It has not been possible in the time available to make a reliable estimate of the additional staff which would be required. The scheme would, however, require total income computations to be made in large numbers of cases where they are not necessary at present (for example, most PAYE cases). If average tax rates were to be used this would entail a further computation which is not required at all under the present tax system: and substantial variations from the normal rules for tax allowances, and special rules for aggregating household incomes, might also be needed. Because of the inevitable delay in arriving at total income and tax payable for a given year, in many cases it would be necessary to provide for enforceable payments on account on some kind of provisional basis. All this would require substantial numbers of additional staff, whether the work was carried out by the Inland Revenue or by local authorities.

A TAX ALLOWANCE OR TAX CREDIT FOR RATES

Tax Allowance

1. The proposition here is that the domestic element of the rate support grant should be replaced by either tax relief for actual domestic rate payments, or tax relief for a range of standard liabilities to local rates broadly related to actual rate levels.
2. Such a relief would at one extreme be worth nothing to a ratepayer below the tax threshold, and at the other would mean that the man taxable at the top rate for earned income (83 per cent) had a reduction in his income tax liability of four-fifths of his rate bill. Distributional effects of this kind would seem to have little to commend them.
3. Merits apart, the proposal would not be easy to operate. This is because at present the information relating to ratepayers, known to local authorities, is not linked to the Inland Revenue's information about taxpayers, and the two systems work so differently that it would not be easy to create and maintain such a link.
4. Among the processes required to work such a scheme would be identifying taxpayers who pay domestic rates, establishing the amount of relief due in each case, and changing the rate of the allowance annually. The first two could be linked together, but would involve either a massive notification exercise by the local authorities to the Revenue, or further enquiries by the local authorities to the Revenue, or further enquiries from the Revenue to every taxpayer. As local authorities and tax districts taking the ratepayers' private addresses would generally not know tax references of people resident in their areas, the notifications from the local authorities of actual rate payments, or the standard allowances due, could not be processed without the Revenue sending enquiries to many ratepayers. If the Revenue sought the necessary information direct, tax returns would have to be expanded, and we should have to send returns to the 12 million people who do not now receive them every year. The allowance would moreover have to be at least one year out of date when given, e.g. actual rates paid in 1975-76 would form the basis of the allowance to be taken into account in the autumn of 1975 - assuming the information could get to the right place in time - in fixing the PAYE code for 1976-77.
- . A 'model' scheme, with an allowance given on a fixed scale rather than for actual rate payments, would be somewhat the simpler of the two; but the crucial difficulty of linking rate information to tax information would remain. On either basis the level of the allowance would presumably change every

year. This would mean an annual PAYE recoding for many people whose code now runs on unchanged from year to year. Inevitably there would also be many more repayments and end of year assessments because the information necessary to give the allowances was not available in time to be included in codings. This would apply particularly in cases in which rates were paid indirectly – e.g. local authority and other tenants who pay inclusive rents.

6. It would however be feasible, if desired, to achieve broadly the same result as a basic rate tax deduction by a different route. So far as the ratepayer is concerned, his rate bill could be reduced by an amount equal to tax at the basic rate on the bill: this would mean his outlay on tax and rates combined was the same as if a tax deduction had been given, though the proportions paid out under each head would be different. The money lost to the local authorities by giving this deduction could then be made up by a payment from central government funds, equivalent to what the tax relief would have cost. This has some similarity to the kind of arrangement which was envisaged under the tax credit scheme (Cmnd 5116, October 1972) for giving relief for building society interest and life assurance premiums at source by deducting tax at the basic rate. In the same way, the rate allowance could take the form of simply deducting tax at the basic rate from *current* rate payments. Arrangements of this kind would give the same measure of relief automatically to all domestic ratepayers whatever their tax position. For the basic rate taxpayer the allowance would be right in tax terms, but it would also, for people at either end of the income spectrum, give a cash allowance equivalent to relief at the basic rate to non-taxpayers or marginal taxpayers, and would restrict the relief to higher rate taxpayers to tax at the basic rate.

7. The foregoing assumes that the allowance would be related to the actual rate bill, or the notional rate for the type of house, irrespective of the occupier's circumstances. If, as was suggested to us as a possibility, it was desired to complicate the scheme by adding some element which took account of family circumstances, so that the standard allowance was modified for children and other dependants, the local authority would have to obtain the information necessary to enable it to include the adjustment in the allowance. And there would also be a problem with the interaction between the new 'tax' allowance and the existing tax reliefs given to employees and business people for rates paid on domestically rated premises which are used partly for business purposes.

Flat-Rate Taxable Credit Against Rates

8. This proposal would replace the domestic element in the rate support grant by a flat-rate credit against rate bills. To add a further element of progressivity to government assistance with rates, it is suggested that this flat-rate credit (possibly about £40 per annum initially) would be regarded as an addition to taxable income and taxed accordingly.

9. If the taxable credit were regarded as a conventional source of untaxed income, the administrative problems would be much the same as for the tax allowance for rates. All the problems of identification would remain – and would indeed be heightened because we would be seeking recipients of taxable

income rather than claimants of an allowance. Once the system was set up there would be no ready way of checking on moves into and out of entitlement to the credit following changes of residence.

10. With a flat-rate credit the amount to be coded out would be certain where the taxpayer was known to be a ratepayer, but there would still be the problem of changes of code if the allowance varied each year, or frequently. Moreover this proposal would increase the number of taxpayers at any one time because, for ratepayers, a fixed increase in income with no change in personal allowances would have the same practical effect as a straight reduction in personal allowances of an equivalent amount, i.e. a reduction of the tax threshold. This could be a serious problem, depending on the amount of the credit. On a £40 credit we estimate that the number of people who (at current income levels) would become taxpayers solely on account of the tax due on their rate credit would be up to 200,000. In addition, collecting tax from some people, especially pensioners, would become much more costly because their tax allowances would no longer be sufficient to cover their untaxed income (ie State benefits plus rate of credit) and the tax due on the balance would have to be collected by means of costly direct assessments. All this implies that the taxable credit would involve substantial staff costs.

11. It might be thought that it would be easier to regard the credit effectively as a net tax-paid sum – that is, a payment after deduction of tax at the basic rate. This would mean that no adjustment was called for except where there was no tax liability (where there would be a repayment) or higher rate liability (where tax would be due over and above basic rate liability). By itself, however, this would probably not offer much of a saving, because of the need to make repayments to the many householders – pensioners etc – below the tax threshold. This suggests the further step, that no repayments should be made to non-taxpayers, and no attempt made to collect further tax from higher rate taxpayers. This would of course make the credit a flat rate non-taxable sum – which might be criticised as hard on the non taxpayer and too generous to the higher rate taxpayer.

But this approach does point up a similarity between the taxable credit and the standard tax allowance proposals both of which, on this basis, would boil down to a flat rate net subsidy against the payment of rates. In conception the two are different, in that a tax allowance franks a given amount of income from tax, and so can be said to be worth more to the higher rate taxpayer, because he would otherwise pay a higher percentage of each marginal pound in tax. With a taxable credit on the other hand the position is reversed; if the credit were regarded as investment income, then up to 98 per cent of it, in the extreme case, would be paid in tax. But both can be reduced, by separation from individual tax liabilities, to flat rate solutions which give somewhat similar results.

Conclusion

12. The administrative costs and complications of running either of these proposals on conventional lines are very, and we would think unacceptably, high. However, as indicated briefly above, much of the desired effect of these proposals could be achieved in other ways without involving the tax system.

NOTIFICATION OF TAXPAYERS TO LOCAL AUTHORITIES

1. The proposal is that the Revenue would notify local authorities of taxpayers resident in their areas so that they could raise a surcharge on households with more than one income.
2. The Revenue does not hold records for people whose total income is below the tax threshold (e.g. many pensioners and part-time workers) or whose income consists largely of non taxable items such as social security benefits or student grants. So any system of notification from the Revenue would not enable the local authority to identify cases where the 'second income' was of this kind; but this may not be felt to be very important.
3. As explained in the note on the determination of residence for LIT purposes, the Revenue's existing information about residence is limited to postal addresses which have been supplied sometime in the past and which may be several years out of date, particularly for the 12 million people who do not receive returns every year and with whom there has been no recent correspondence, and for married women whose records would not necessarily be updated when the husband reported a change of address.
4. For the purpose of levying a surcharge, a taxpayer would probably need to be deemed to be resident in a particular local authority's area if he was resident there either for some period during a basis year, or on some particular date. Revenue records would not at present give 'residence' on either basis.
5. Even if they did, it would be a substantial undertaking to transmit the existing information we have to local authorities. Except for PAYE taxpayers in Scotland, taxpayers' names and addresses are not held on computer records, but on manually prepared control cards. All these names and addresses would have to be transcribed to a list which could be given to the local authorities. Because PAYE records are not kept by reference to a taxpayer's private address, there would be little correlation between the taxpayers dealt with by a particular tax district and the local authority area in which that tax district was situated. So local authorities would have to set up a clearing house to sort up to 30 million names and addresses into local authority order.
6. If it were desired to use this kind of information already within government as a basis for starting the identification of cases possibly liable for surcharge, the National Insurance records held by the Department of Health and Social

Security might provide a more satisfactory starting point as they are computer based. Their records would not cover exactly the same field as ours, but one way or another they would have a record of almost every person receiving income of an amount above the tax threshold—though there might be difficulty in producing data for pensioners in employment (who do not pay National Insurance contributions) as distinct from pensioners generally.

7. Since the information on existing Revenue records would not itself form an adequate basis for identifying cases liable to a local authority surcharge, the most practical course would probably be for the Revenue to issue a residence inquiry to each taxpayer which could then be passed on to a local authority clearing house (instead of a list of names from which the local authorities would have to issue their own enquiry). The cost of issuing such an inquiry for the 24 million PAYE taxpayers (allowing one reminder and a 10 per cent failure rate—for which cases we would supply the latest information we had) would be about 1,500 to 1,700 staff units. For the reasons explained in the note on the determination of residence for LIT, it would probably be necessary to make a full issue of such returns each year.

8. The possibility of some exceptions (e.g. married women) being excluded from this operation *ab initio* has been mentioned, with the implication that the Revenue would not need to pass over information about the excluded groups. No such exempt categories are taken into account in the figures mentioned above, and unless such categories could be very easily identified from our records, they might add to the cost of the operation rather than the reverse.

9. The Revenue's rules of confidentiality prevent any information (including private addresses) obtained in connection with income tax being used outside the Department. Before a scheme of this kind could be brought into operation, the Revenue would need to be statutorily released from its obligations as to secrecy so far as was necessary to operate the scheme.

INLAND REVENUE COSTING METHODS

Introduction

1. The basis on which staffing estimates are made in the Inland Revenue for taxes work is broadly as follows. Factors are used for translating measured volumes of work into units of staff. The factors used are derived from, and updated annually by reference to, the field operations of a Staff Investigation Unit. In calculating overall staffing needs for the many sections of the Department, provision is also made for the inexperience of staff, trainee requirements and wastage rates.
2. Costing of any new task requires a full knowledge of the ambit of the task together with a complete and detailed build-up of all the steps that have to be taken. Each operation can then be timed. Of course, with the experience available in the Department from past exercises, time factors for most of the common operations are already known. Public reaction in terms of likely appeals, correspondence, telephone calls and visits to the local tax or collection office is a further important factor which must be estimated and costed. A percentage addition is also required for the ancillary services relating to any additional staff needed.
3. When the task has been costed in terms of units of staff, the money costs can be calculated, based on the average salary paid by the Inland Revenue to the grade of staff appropriate to the job, with a proportionate addition in respect of London Weighting if the job is to be done wholly or partly in the London pay area. A further addition is normally made for ERNIC and Superannuation.

4. Overheads

Additions are made as appropriate for common services (e.g. typing, messengers, central registry services, telephones, postage and small office machines), often as a percentage of the cost of the additional staff numbers. Where overall costings are necessary, additions are made in respect of stationery and accommodation.

Estimates of Volumes

5. The volumes of some tasks are known from existing records. In other cases estimates of volumes of each task, where these are not available from the Statistics Division, are obtained by *ad hoc* surveys or activity sampling

(where time permits) or are based on experience built up in the costing unit. Inevitably where a new task is concerned, the volume must be to some degree a matter of estimation, but there are often analogous existing tasks from which guidance may be obtained.

APPLICATION OF COSTING METHODS TO SAMPLE SCHEMES

6. With most Revenue operations the information needed for this type of costing is available, or can be accurately estimated, by reason of previous experience. With the costing for local income tax there was inevitably a large area of uncertainty in the various schemes envisaged. Thus the costings for LIT were built up by setting out in broad terms the various processes which seemed to be implied by the outline particulars of the schemes proposed, based on our existing experience in the income tax field. But many of the processes were novel ones, to a greater or lesser degree, to which no precise analogues exist, and it must follow that, as noted in para 48 of the Board's memorandum of March 1975, the costings must be regarded as approximations only, to indicate little more than the order of magnitude of the staff needs which might be involved.

7. The Committee asked what were the schemes costed; what was the basis of the incremental cost of the variable rate scheme: and what were the unit costs used.

8. The schemes costed were those outlined in paragraphs 32 et seq., 36 et seq and 46 of the evidence of the Board of Inland Revenue to the Committee of Inquiry which are briefly:

Scheme 1

Local Income Tax as a surcharge at national level with non-variable rate of tax. The Revenue would assess, collect and allocate to the local authority.

Scheme 2

Local Income Tax as a locally variable surcharge. The Revenue would take the same action as for Scheme 1.

Scheme 3

Local autonomous tax assessed and collected by local authorities on income details supplied by the Revenue.

9. The incremental cost of the variable rate scheme was not aimed at on a detailed limit cost basis, as such. It represented an estimate of the overall complexity of the work, compared with that of the uniform rate scheme. The figures took account, in broad terms, not only of the additional physical process involved in imposing and collecting tax at the different rates, but also the inevitable consequential difficulties, by way of more appeals and more queries from taxpayers and employers - which would be met if the determination of residence affected the total tax due.

10. The broad costings given for the 3 schemes were based on the average 1974 salary costs of the grades which would be mainly involved in operating these schemes (Tax Officers and Assistant Collectors) ie about £2,000 a head. The corresponding figure per head at current salaries, including ERNIC and Superannuation, would be about £3,000. The costs given were purely staff costs, without any addition for overheads: a full costing, including all administration costs and overheads, would increase the figures by some 35 per cent (and this would then increase the number of staff required somewhat).

COSTING OF MODEL SCHEME

11. The outline scheme proposed in the Committee's paper contains several different possibilities but our costing of it has been based on the most economical of these. The outlines of this are set out below:

All individual taxpayers to be included.

For the initial setting up operation, special returns would be issued to all taxpayers to enable residence to be determined for LIT purposes. Thereafter 'residence' returns would be issued in each year only to taxpayers who were not required to complete a tax return for that year.

Employers to apply variable rate LIT (from tables) to pay as defined for PAYE purposes, by reference to comprehensive coding.

Schedule D (Case I and II) and Schedule E assessments to include a LIT element.

Similarly with assessments needed to cover investment income not taxed at source (Schedule A, Schedule D Cases III to VI).

Income taxed at source, including building society interest, to suffer a flat-rate deduction for LIT.

While any individual's LIT liability must be susceptible of precise determinations, the amounts paid over to local authorities would not be exactly calculated from their residents' LIT payments, but would be worked out in a sampling basis.

12. On these rather bare bones the minimum staff cost on a continuing basis is estimated to be in the region of 17,000 for assessment etc, plus about 1,200 for collection.

13. Of the figure of 17,000 given for the assessment etc. cost, something like 5,000 would be needed, on a continuing basis, for the work of updating each year the residence location coding for existing and new taxpayers.

SELF ASSESSMENT FOR LOCAL INCOME TAX

1. By way of background, we would restate part of paragraph 49 of our main paper: "For any reliable system of self assessment which has the respect of taxpayers, some system of checking information would be indispensable. . . . Unless elaborate and expensive cross checks are built into the system the revenue losses may be considerable as a result of a lower level of taxpayer compliance and greater scope given by a self assessment system to understate income and make errors of all kinds. To counter such losses it is common to find that self assessment systems incorporate rigorous and mandatory penalties of the kind for which there is little precedent in the direct tax field in this country".
2. Time has not allowed us to do more than construct the skeletons of 2 possible schemes of self assessment, and for neither have we sought to determine (or, *a fortiori*, cost) the kind of special sanctions which might be appropriate in this field. Even leaving this aspect aside, there would be many problems to be solved before a properly worked out scheme could be produced on either basis.

3. The two schemes are:

Scheme A: a scheme run wholly by the Revenue;

Scheme B: a scheme run mainly by the local authority.

The salient features of each, together with the foreseeable snags, are set out below.

4. Scheme A

Inland Revenue local tax offices would issue self assessment returns for local income tax to all Inland Revenue taxpayers on their books. The returns would require the taxpayer to declare his residence and to insert a 'residence indicator'. They would also show the local income tax rate of all the 66 local authorities so that the taxpayer could calculate the amount of LIT he should pay. (Returns might not be sent to all domestic ratepayers; there might also be duplication where both husband and wife are working, or where someone has more than one job.)

The completed returns would be sent back to the tax office with an indication of the appropriate local authority and a cheque for the money calculated by the

taxpayer to be due. To complete the return he would need to compute his own total income by reference (it is assumed) to the national tax rules. (Many people do not know the national rules well, and would need help to complete the form. Different rules would greatly add to the cost.)

A percentage sample of the returns would be examined in the tax office against Revenue information and discrepancies pursued with the taxpayer.

Reminding action would be necessary for taxpayers who failed to render their returns promptly; if the failure to render a return continued, delivery would have to be enforced by an estimated assessment or proceedings for penalties. (There would be little incentive to render returns promptly and the compliance level might be very low.)

If the return was rendered without the money, or if the tax charged by an estimated assessment remained unpaid, collection of the money would be pursued, if necessary in the courts. (This would be an even more burdensome problem if provision was made for payment of local income tax by instalments.)

Money paid would have to be allocated and transferred to the appropriate local authority. (As well as problems of identification and balancing, there would be the difficulty that the local authority would, initially at any rate, not know with any certainty its tax base, nor, therefore, the likely yield; and that this would be more likely to fluctuate than, e.g. rateable value).

The estimated staff costs for the Revenue under Scheme A are in the region of 24,000 for the returns and assessment work and 30,000 for the collection work, i.e. 54,000 in all.

5. Scheme B

Local authorities would issue returns to all those on the Electoral Roll (say 39 million). This may involve duplication if husband and wife are to be treated as one. Wage earners who had recently moved would not be included, nor would taxpayers under age 18, aliens, and the voluntary non-voters; it would be for consideration what steps should be taken about these.

Local authorities would receive completed returns together with the money, either in one sum or by instalments over a period. (As with Scheme A, it is assumed that the national rules for determining income would apply; otherwise Revenue involvement need extend no further than checking totals and sources – but the local authority burden would be more than correspondingly increased.)

The local authority would follow up the missing returns and take any necessary enforcement action including the making of estimated assessments (presumably after reference to the Revenue).

A sample (X per cent) of returns would be sent to the Revenue for audit. (The task of cross referencing the national tax records would be very considerable indeed; tax records are spread over some 700 tax districts, the district being

determined either by the address of the employer, or by the taxpayer's residence or by his place of business.)

Either

- a. the Revenue would examine the sample returns and tell the local authority of discrepancies. The local authority would then take up the discrepancies and take such further action as might be necessary
or
- b. the Revenue would pursue the discrepancies and report back to the local authority when they were resolved.

(It is assumed that the confidentiality difficulties would be dealt with.)

The cost to the Revenue of Scheme B is estimated to be in the region of 6,000-10,000 staff, and to the local authorities up to 20,000 staff for returns and assessment and 30,000 for collection.

There might be some scope for local authorities to reduce these figures by combining the work on the returns etc. side with what they currently do on rent and rate rebates etc., and on the collective side with the rate collection machinery, but we are not in a position to judge the possibilities here.

6. Difficulties of checking and enforcement would arise irrespective of whether the scheme were administered by the Revenue or local authorities. The fundamental problems would be to ensure that all taxpayers within the national income tax net were also caught in the appropriate local income tax net. If the Electoral Roll were used as the basic record of local income tax taxpayers, it might become less reliable, if people decided to give up their right to vote in order to escape local income tax! Difficulties would also arise from the simultaneous operation of two different taxes: taxpayers could be expected to exploit the difference, attempting to use the Revenue to complete their self-assessment forms and subsequently blaming the Revenue for their own errors, omissions and delays. No doubt many taxpayers would, at least initially, find difficulty in coping with self-assessment personally. In the United States of America, despite intensive taxpayer education, a high proportion of the work of completing self-assessment returns is entrusted to private agents.

LOCAL INCOME TAX BASED ON PLACE OF EMPLOYMENT

1. The Committee asked us to consider whether basing local income tax on the place of employment, rather than the place of residence, would reduce the cost to the Revenue and to employers of administering it.
2. A place of employment test could not apply right across the board. It would be necessary to have some other test for determining the local income tax liability of the self-employed, people living on investment income, and, within PAYE, occupational pensioners. Having two sets of rules would be a complication, and the interface between them would produce awkward cases, e.g. which set of rules should determine the local income tax liability of the pensioner with part-time earnings, or the self-employed man who also has employment income? There are many examples of the latter - a doctor in private practice with a hospital appointment assessed under Schedule E, or a practising accountant or solicitor with a directorship.
3. In our note on the determination of residence we suggested that it would be unsatisfactory to settle a person's residence by reference to the circumstances of a single day. For the same reasons, a place of employment test would need to consider the circumstances over some previous period, and the necessary information would have to be given to the Revenue to determine the appropriate local income tax rate. There would then be three main problems. First, the number of changes of employment during the year. There are some ten to eleven million changes of employment within PAYE during every year. Many would involve a change of residence for local income tax purposes because they resulted in the employee working in another local authority area, although the employee may not have changed his house. Second, a worker might stay with a large employer for many years, but his local income tax rate would change as he moved from branch to branch, office to office, or shop to shop, within the same organisation. This kind of movement may be frequent within a year, and would all be additional to the changes of job noted above. (It would be administratively convenient, but unacceptably crude, to deem the place of employment in a large organisation to be the location of the payroll.) Third, there are some kinds of job which do not fit easily into the place of employment concept, for instance agency workers and travelling salesmen. There seems little reason to suppose that the number of awkward cases and changes within a year would be less if place of employment were substituted for place of residence.

4. The previous paragraphs envisage that place of employment would be used instead of place of residence in determining a taxpayer's local income tax code for a tax year. If place of employment determined the local income tax rate, another possibility would be to dispense with the Revenue notification of the appropriate code, and for the employer automatically to apply the local income tax rate for the area in which the employee worked. This might work for some small employers with a stable work force and only one work place, but it would pose enormous administrative problems for firms where workers were not always employed at the same place. There would have to be some mechanism for settling disputes (the employer could not be left as the final arbiter of the appropriate local income tax rate) and the employer would also have more complicated recording and accounting because under this system the local income tax rate could vary within a tax year. Without full information about the various rates of local income tax used, the Revenue would not be able to check the accuracy of tax deductions at the end of a tax year, and this would also be needed (at least on a sample basis) to allow the local income tax deducted to be allocated to the appropriate local authorities. It is, in any case, difficult to see how cumulative PAYE deductions could be reconciled with changes in the local income tax rate within a tax year following changes of job or place of work within the same organisation, but local income tax deductions operated on a non-cumulative basis would greatly complicate the present PAYE system.

Conclusion

5. These considerations lead us to think that a local income tax based on place of employment would be less satisfactory than one based on place of residence. It would be necessary to have another set of rules for non-employment incomes, and even within the employment field the problems would apparently be at least as difficult as with a residence test. It would probably be unworkable for employers to operate a place of employment rule themselves on the lines indicated in the previous paragraph.

COST OF COLLECTION OF TAXES AND INLAND REVENUE DUTIES

The most up-to-date figures which we can give are set out in the Board's Report for 1974, and relate to the tax year 1973/74. The percentage cost of collection of all Inland Revenue duties was 1.71 (i.e. yield: £10,620m., cost of collection: £181m.), whilst the cost of collection of taxes on income, profits and capital gains was 1.75 per cent (i.e. yield: £10,100m., cost of collection £175m.), of the net receipts of those taxes. The percentage costs in respect of death duties and stamp duties were 1.04 (i.e. yield: £412m., cost of collection £4m.), and 1.03 (i.e. yield: £119m., cost of collection £2m.), respectively. These figures do not apply to the tax on development gains or the proposed taxation of wealth and development land, for which no information is available; a crude estimate of the costs of collection is about 5 per cent of the tax receipts.

LOCAL INCOME TAX LEVIED THROUGH A REDUCTION IN PERSONAL TAX ALLOWANCES

1. The Committee asked us to give further thought to a scheme under which local income tax would be collected not as a supplementary rate of income tax, but through a reduction (up to a ceiling specified by central government) in the personal tax allowances of individuals. The intention would be that the Revenue would automatically make the maximum deduction possible for coding and assessing purposes, unless the taxpayer produced a certificate from his local authority showing that in his case a smaller deduction was due because he was a resident of the local authority which had taken up less than the maximum tranche of allowances available to it.
2. Such an arrangement would place on the local authority, instead of the Revenue, the responsibility for determining the taxpayer's place of residence. This would have to be done by about July/August before the start of the tax year in which the reduction was to apply, to allow time for the certificate to be passed from the local authority to the taxpayer and on to his tax office in time for it to be taken into account for the annual PAYE recoding which starts about October. Before the first certificates were issued the local authority would have to decide what its take-up for the following tax year would be. This would present it with two problems - first, that a decision would have to be made much earlier than is necessary for rates, and second, that the amount raised by any particular tranche of allowances would be dependent on the tax rates fixed by the Chancellor the following Spring (as well as changes in allowances which would affect the tax base).
3. Even if local authorities could issue all their certificates promptly, this arrangement would still result in a substantial clogging of the tax machine. However explicit the instructions, a large number of taxpayers would either not send their certificates at all, or send them in such a way that they could not be readily linked with their tax records. Those who had not sent their certificates might do so at the start of the tax year when tax deductions by reference to the 'penal' coding containing the maximum deductions started, which would mean that they would have to be recoded. If they did not send their certificates in until after the tax year had finished, there would need to be an end-of-year repayment. There would be a lot of tracing work where certificates were sent with incomplete particulars, and even where the certificate found its way quickly to the right file, it would mean in many cases a coding adjustment to a code which would otherwise have run on unchanged for another year. It is not possible to evaluate the additional work with any degree

of accuracy because the number of cases we at present recode in the Autumn varies greatly from year to year (e.g. the forthcoming switch from child tax allowance to child benefit will call for a recoding of all families with children); and because it is impossible to assess how frequently local authorities would want to change their 'take-up'. If 'take-up' changed frequently, almost everyone would need a new code each year. Even in a year in which there was no change at all in 'take-up', it would still be necessary to have a certificate for every taxpayer entitled to less than the maximum deduction from his personal allowances.

4. The need for a certificate before the right code could be issued would act as a drag on the PAYE system generally. New entrants to the work force (for instance school leavers, overseas residents, housewives, pensioners seeking employment again) would find that either a certificate had not been issued to them at the normal time, or that it had been lost as it was of no interest when it was received. This would mean a further coding adjustment would be necessary when the certificate was produced, and if, meanwhile, the tax year had ended, an end of year adjustment would also be necessary.

5. Despite these difficulties, this scheme would be considerably less complicated for the Revenue than charging LIT at a variable rate. Instead of superimposing on top of an already complicated system a second tier of taxation which at many points would have to be kept separate, or would at best fit uneasily with income tax, this arrangement would dovetail into the existing pattern far more closely. It would also be far more acceptable to employers because it would entail no change in the present system although, for the reasons explained above, they would have to deal with more code changes.

6. The scheme does, however, appear to suffer from two serious disadvantages which offset its greater administrative convenience. First, in the form proposed, it would not provide an additional source of finance for local authorities, but an alternative for part or all of the Rate Support Grant. As we understand it, the intention would be that part or the whole of the Rate Support Grant would be withdrawn in return for a corresponding increase in personal allowances across the board on which local authorities would be free to draw. If this adjustment were to be made on a 'revenue-neutral' basis, there would be no scope for any overall reduction in income tax: for if local authorities as a whole were to be no worse off, the direct flow of tax to them from allowance reductions would have to be no less than the indirect flow via RSG which it replaced. Thus the *average* tax threshold would be the same after the scheme as before: and if different local authorities made different allowance reductions, the result would be that some people ended up with a lower tax threshold than before and others with a higher one. This outcome could only be avoided if the payments to local authorities under the new scheme were less than the reductions made in RSG, or if the introduction of the new scheme was accompanied by a switch on the part of the central government from direct to indirect taxation. In the absence of either of these, the net reduction in allowances which would be necessary in a proportion of cases, coupled with the greater reduction which would be called for where the penal basis applied, would - given the present level of tax thresholds - represent a very serious obstacle to the idea.

7. A second disadvantage of this scheme is the distribution of the tax burden. While those below the adjusted-tax threshold would escape altogether, for incomes above the tax threshold the tax would in effect be a flat rate poll tax so long as a taxpayer was liable only to basic rate income tax, and even for incomes liable to tax at the higher rates the range of liabilities would be so small that the tax could hardly be regarded as progressive. Moreover the lower ranges of taxable income would suffer more heavily than with an LIT charged at a percentage rate. This is because while an LIT charged at a percentage rate would be strictly proportionate to taxable income, an LIT charged as a withdrawal of personal allowances in effect would treat everyone as having the same LIT income, and the only variable would be the marginal income tax rate. The table below gives a few examples to bring out the position. For the purposes of comparison, the table assumes that the local authority maximum take-up level is £100 and this amount is taken up in full.

TABLE 3
COMPARISON OF TAX BURDENS: LIT WITH A VARIABLE RATE AND
LIT LEVIED THROUGH REDUCED PERSONAL ALLOWANCES

Taxable Income ¹	Local Income Tax Liability with (a) LIT at 3%	Local Income Tax Liability with (b) LIT 'take-up' of £100 allowance
£ 100	£ 3	£35
£ 500	£ 15	£35
£ 1,000	£ 30	£35
£ 4,500	£ 135	£40
£10,000	£ 300	£65
£50,000	£1,500	£83

Note:

This is not strictly a like with like comparison, because the LIT at 3 per cent would represent an *additional* tax burden so far as the taxpayer was concerned, whereas the 'take-up' is in effect an allocation to the local authorities of tax which would otherwise have been paid direct to the central government as part of the general income tax bill.

There is the further point that for the man near the tax threshold, differences in LIT 'take-up' would have a disproportionate effect on tax liability. For example, where the local authority 'take-up' was only £50, a man with the same gross income as the £100 man in the above table would only have £50 taxable income, and an LIT liability of £17.50. It would be difficult to justify this kind of difference.

8. We conclude that this is not an attractive scheme because in substance it seems to do little more than rearrange the mechanism of government support for local authorities while leaving the amounts the same and the burden broadly in the same hands – and this at the cost of some considerable administrative complexity. As soon as the scheme is modified to raise additional revenue, substantial difficulties arise with the tax threshold as well as the distribution of the additional tax burden.

¹ After deducting all allowances, but before the LIT 'take-up'.

LOCAL INCOME TAX: INVESTMENT INCOME

Introduction

1. Under the proposed general LIT structure the tax would in relation to earned income:
 - a. apply to individual taxpayers only;
 - b. be charged according to the person's place of residence at a particular date prior to the tax year;
 - c. be charged as a flat percentage of taxable income - i.e. gross income less personal allowances as granted for national tax purposes;
 - d. be collected by the Inland Revenue in conjunction with, and without distinction from, national tax: a sampling procedure would be used to produce a yield to each taxing authority depending closely on the local rate set on the taxable income base for the area.
2. An outline scheme has been suggested under which investment income from which tax is deductible at source would be subject to a further deduction for LIT. This deduction, however, would be at a composite rate, to avoid the need for variable rate deductions according to the residence of the recipient (variable rate deductions would be impracticable - see paragraph 14 below). Investment income not paid under deduction of tax would, however, be subject to a variable rate, according to the recipient's abode: such income is currently either assessed direct under Schedule D (so that account can be taken in the assessment of place of residence), or 'coded out', i.e. dealt with by a PAYE adjustment, so that the right result will be obtained automatically.
3. In our view such a scheme would not be viable, because it would mean that different types of investment income would bear quite substantially different tax simply because of the different administrative arrangements for taxing them. To pitch the composite rate at the top LIT rate would aggravate this; alternatively to pitch the composite rate in the middle of the range would have source-taxed investment income in some areas paying tax at a lower rate than earned income, and we doubt if this would be regarded as tolerable.
4. This note therefore seeks to consider what form an alternative solution might take.
5. We approach the question on the basis that it is necessary, if at all possible, to avoid the collection of small amounts of income tax from large numbers

of individual recipients of investment income. Anything on these lines would be a major administrative burden. This suggests that the aim should be the extension of arrangements for the deduction of tax over a wider field than it applies at present.

Types of Investment Income

6. Investment income of United Kingdom residents falls into the following general categories:

- a. interest on United Kingdom Government securities;
- b. debenture and other loan interest;
- c. mining rents, patent royalties etc;
- d. annual payments including alimony;
- e. bank interest;
- f. building society interest;
- g. company dividends;
- h. rents;
- j. interest and dividends from abroad.

7. National income tax is already deducted at source by the payer for most income in categories a and b. The interest on certain government securities is, however, paid tax-free; and such payment is a term of the conditions on which the securities were issued. When this matter was considered in the context of the Tax-Credit scheme, the Bank of England took the view that deduction of tax would be regarded as a breach of faith on the part of the Government, and we think they would regard the deduction of local income tax in the same light. National income tax is also deducted from income within c and from income within d, except alimony paid under a court order and not exceeding £12 per week or £52 per month. Subject to the comments in 13 below it would *prima facie* be possible for institutional payers of income in these categories to deduct local income tax at source. The matter would, however, be much more complex with *individual* payers. For national income tax, if the individual makes his payments out of taxed income he is entitled to retain the income tax deducted and does not have to account for it separately to the Revenue. In his case, therefore, the deduction and accounting of local income tax would be a significant additional task, leading to complication and confusion, and it might have to be accepted that he could not take this on. In such cases it would, therefore, be necessary to recover LIT by an assessment on the recipient at the end of the income tax year (in the same way as it would be necessary to assess profits from an individual's trade or profession to LIT).

8. For national income tax, bank interest (category e) is credited gross to the recipient's account and tax is assessed on him, or else a PAYE adjustment is made in the recipient's coding. (The latter is what happens in the great majority of small cases.) Because of the problems inherent in applying a variable LIT rate generally to investment income and the impossibility of taxing bank etc. interest alone at a variable rate, it would seem to be necessary to go over to deduction at source here. This would present difficulties and complications for the banks in deducting and accounting for LIT - see 13 below - though these

would not necessarily be insuperable. It would seem to follow that the interest should be paid under deduction of national as well as local income tax.

9. Building society interest (category f) is paid under special tax arrangements under which the societies account for their investor's tax liability at a composite rate (i.e. an average rate covering all investors). They do not deduct the tax from the interest; nor is the recipient charged to basic rate tax. The rate of interest paid by the societies, however, takes account of the composite rate tax which they pay on behalf of their investors. Nevertheless – subject to the comments in 13 below – the societies could *prima facie* be required to deduct local income tax when paying interest.

10. For United Kingdom dividends (category g) the present corporation tax imputation system does not provide for tax to be deducted from dividends. Each taxpayer is given a tax credit which effectively covers his basic rate liability on the dividend; this credit is shown on the dividend voucher. Nevertheless, subject to the comments in 13 below, United Kingdom companies too could be required to deduct LIT when paying dividends.

11. National income tax is not deducted at source from rents (category h), but charged on the recipients after allowing the cost of maintenance, repairs, management etc. The same course would have to be followed for LIT.

12. Interest and dividends from abroad (category j) are subject to deduction of national income tax at source i when they pass through the hands of a United Kingdom paying agent or ii when they are 'cashed' by a bank etc. *Prima facie*, LIT could be deducted here too, subject to the comments in 13 below.

13. In the comments in the preceding paragraphs it has generally been assumed that an institutional payer should be able to deduct LIT and account for it to the Revenue. There is no doubt, however, that this extra task would be a substantial additional burden for these bodies. Many types of payments are computerised and the need to provide for a further item would require the alteration of computer programmes, dividend vouchers etc. The probable resistance to this by the bodies concerned should not be underrated.

Rate at which LIT Deducted

14. Ideally, LIT should be deducted at the rate appropriate to each recipient of investment income. Deduction of tax at variable local rates, however, would create enormous administrative problems for payers – in addition to those mentioned in 13 above. They would be faced with deducting tax at numerous different rates depending on the address of the payee, and then accounting separately for the tax appropriate to each local authority area. Quite apart from the very heavy extra work involved they would face the following particular problems :

- a. securities held in the names of nominees whose addresses are different from those of the beneficial owners;
- b. lack of recipients' addresses in computer programmes where the dividends etc. are paid direct to a bank account;

c. the probable inability in some cases of the computer programmes to take on a variety of different rates and identify different local authority areas.

15. In short, deduction of LIT at variable rates would be impracticable. LIT would, therefore, have to be deducted from investment income at a composite rate; to avoid investment income being taxed at a lower rate than earned income, this would in practice probably have to be set at or above the top rate of LIT. This composite rate would have to be the final LIT rate for each recipient in respect of his investment income. For such a scheme, it would be necessary to change the law so as to require deduction of tax from bank deposit interest etc. And it would presumably have to follow that in those cases where investment income was still paid gross and directly assessed – e.g. because it related to Government securities where there was a contractual right to have interest paid gross, to rents, or to interest paid by individuals – the LIT would be at the special investment income rate, not the local rate. The ‘coding-out’ of investment income under PAYE would have to disappear.

16. At present, an individual can say against which income he wants his allowances set, but the course followed makes no difference to his *overall* liability. The liability of an individual to two different LIT rates – the local rate for certain types of income and the composite rate for other types – would mean that his tax bill could vary according to how his personal allowances were allocated. To regulate this by statute, however, would be a significant complication of the tax system.

Recipients Other Than Individuals

7. Since LIT would be confined to individual taxpayers, deduction of LIT at source should ideally be confined to recipients within that category. It would be difficult to operate such a limitation. Even if companies, for example, were able to distinguish safely between individual and corporate recipients of their dividends where shares were registered in the beneficial owner’s name, they would not be able to do so in the case of nominee holdings. Many holdings, too, would be in the names of trustees – sometimes for charities, clubs, etc., and in other cases for a variety of trusts for the benefit of individuals. To the extent that it was impracticable for payers to distinguish beneficial individual ownership, it would be necessary for LIT to be deducted, leaving it to the non-liable recipients to reclaim the tax. (The same point arises as regards United Kingdom interest etc. paid to overseas residents, assuming that they were left outside the scope of LIT.) This would substantially add to the administrative costs and inconvenience of the tax.

18. Quite apart from the mechanical point of deduction at source, there is the substantive question of how far trusts with a variety of beneficiaries, some individual and some non-individual, should be within the scope of the tax. So far as the trustees were charged to LIT there should be no further charge on the beneficiaries when they received income from the trust. It would be for question whether beneficiaries whose personal allowances exceeded their non-trust income should be allowed to reclaim LIT attributable to their share of the trust income.

Repayment Claims by Individuals

19. In addition to claims to repayment of LIT by corporate etc. recipients (see 17 above) repayment would also be necessary in respect of the personal allowances of persons living wholly or mainly on investment income. In most cases this would have to be done together with their repayment claims for national income tax. It would add to the work involved in handling those claims.

Estimate of Work Burden

20. *Inland Revenue*

The additional tasks for the Inland Revenue would be as follows:

- (i) collection of LIT deducted from all categories of investment income to which deduction at source was to apply;
- (ii) assessment and collection of LIT chargeable on investment income not taxed at source;
- (iii) repayment of LIT deducted from income of companies and other bodies outside the scope of LIT;
- (iv) repayment of LIT to individuals having an investment income (in respect of their personal allowances);
- (v) periodic payment of LIT to local authorities.

In the time available it has not been possible to estimate the additional staff required; an estimate will be sent as soon as possible.

21. (a) *Payers*

The extra work burden in connection with LIT would fall mainly on companies (who would have to operate a separate deduction scheme for dividends, in addition to the tax credit imputation system) on building societies, banks, local authorities, and the Bank of England (as regards Government securities). This additional work would be substantial; but we cannot estimate the cost.

(b) *Recipients and their Advisers*

Recipients could well find it very difficult to follow the different rates of tax deduction or non-deduction as the case might be and might well find it necessary to seek professional advice to a greater degree than they do at the present time, with of course considerably more cost to themselves.

Conclusion

22. We think that the scheme outlined above, involving

- (a) deduction at source on a much wider basis than at present;
- (b) a single LIT rate for all investment income;
- (c) assessment to LIT at that rate, not a variable local rate, of investment income received by individuals where deduction at source is not practicable;

is the nearest approach to a viable scheme which can be constructed, given that the income tax system remains one in which year-ending assessment is the exception.

23. Such a scheme would, however, involve a considerable amount of extra work, much of which would fall on the shoulders of banks, companies, etc.; and it would mean that the LIT rate on investment income would be the same throughout the country and was not a genuinely 'local' rate: in effect, it would be a higher basic rate of income tax on investment income received by individuals, the produce of which would be hypothecated to local authorities on an 'income base' formula. The determination of a local authority's taxable base would be made somewhat more complicated because it would have to be divided between the earned and investment income component. Similarly the authority, in fixing its rate, would have to take into account that investment income would be taxed at a fixed rate, and that the variable rate would apply only to the earned income element of its taxable base.

LOCAL INCOME TAX: COSTS, STAFFING AND TIME SCALE

1. From the staffing point of view, the time required to introduce LIT might be affected by several factors. If the demands of Wealth Tax and the Community Land programme on tax offices are taken into account it is unlikely that staff could be assimilated in anything like the numbers required before 1978 or 1979, with a subsequent build-up period of, say, two to three years at the very least. The need for LIT to be preceded by a simplification of the relief arrangements for Building Society interest and Life Assurance – which in itself would create an initial need for extra staff before any savings were effected – might well impose a further delay. The “early 1980’s”, which we have previously quoted, remains the earliest we could possibly contemplate. Even this may be over-optimistic.

2. As for the long term staffing cost of levying LIT at different levels, our original estimate was that this would be:

<i>County level</i>	<i>Metropolitan Districts and London Boroughs, and remaining Counties</i>	<i>Districts</i>
17,000	18,000	20,000

On the assumption, made before, that there would be no direct attribution of individual payments, the collection costs can be taken as about 1,200 for each level.

We have not yet been able to complete our re-examination of these figures, on the basis of a ‘simplified’ tax system of the kind discussed at the oral evidence session. We will let the Committee have our considered view as soon as possible.

3. The staffing figures for the ‘District’ basis, while they represent our best effort to evaluate the work involved, are subject to the reservations set out in the Department’s letter of 1 October, that is, our view is that such a scheme could not be expected to operate satisfactorily. This remains our opinion even on the assumption that the personal tax system had first been simplified on the lines indicated at the oral evidence session.

4. This is because of the multiplicity of different areas into which taxpayers would have to be divided: each tax office could well have people in any one of the 450 odd districts in the United Kingdom. This would make identification much more difficult, since addresses by themselves would often not be an accurate guide, and changes of address would more frequently involve a change

of LIT area. Even though the range of rates was limited, the rate charged in a particular area could vary from year to year, so that every case would need individual review.

5. Moreover, the reduced size of the rate-fixing authority would make the determination of the size of the taxable base much more difficult: an annual sample survey of the order of 2-3 million could well be needed to achieve a satisfactory level of accuracy. And the 'base' would of course be much more liable to be distorted, on account of, e.g. concentrations of commercial and industrial property, particularly if all taxpayers – including self-employed professional men and traders – were taxed on a residence basis.

6. The assumption that the rate for each district was a combined county and district rate analogous to the existing procedure for rating, would not seem to affect this general conclusion: the result would be that there would be a separate rate fixed for each of the 450 odd districts (though the rate in each case would be arrived at by summing X per cent for the county and Y per cent for the district). It is difficult to evaluate the practicability of the 'intermediate' proposal, which would involve 119 authorities in levying a rate. While it cannot be ruled out as firmly as the district proposal, there is no doubt that the approximate doubling of the number of rate-fixing authorities would add substantially to the operational problems, for the areas of metropolitan districts are comparable to those of non-metropolitan districts rather than of counties. Given the uncertainties involved, while we would not rule out the possibility of this, we are bound to say that we have serious reservations about it.

IMPACT ON OTHER DEVELOPMENTS: TAX CREDIT SCHEME

1. As was said at the last oral evidence session, we do not think that the existence of a LIT scheme would of itself make the introduction of a tax credit scheme – assuming that the Government of the day wished to introduce such a scheme – either more or less difficult. Clearly, however, there could be problems of timing: both a LIT and a TCS would represent major upheavals, and if it were desired to introduce both, there would have to be a gap of some years between the two to enable whichever came first to settle down.

LOCAL INCOME TAX: TRANSITIONAL PROBLEMS FOR INLAND REVENUE

(a) General

The transitional problems immediately apparent are those of:

- (i) recruiting, training and accommodating the additional staff required;
- (ii) asking existing staff to assimilate a new tax together with a steady stream of changes in the existing tax structure. The learning of new procedures for a major new tax would inevitably have an adverse effect on standards. Also to be expected during this period would be increased complaints from taxpayers, an increase in the arrears of work in tax offices and some resentment on the part of those (e.g. employers) required to administer the tax.

(b) Computer Policy

1. *Computer Policy for PAYE:*

The abandonment of the tax credit system was followed by a study within the Inland Revenue of ways and means of progressing along the road towards the most efficient use of computers in the PAYE field. As a matter of general policy it was agreed that the programme of Regional Centres (East Kilbride being the first) should be discarded and that future planning should be on the assumption that PAYE clerical work would be left in its current location.

Implementation of any national computer system for PAYE is a major task, and the Inland Revenue study group decided that there was no prospect of setting up the complete system in a single operation, even on a regional basis, let alone on a national one. The most intractable problem (but by no means the only serious one) was that of acquiring the staff needed for the operation. The only real prospect of realising the long-term objective was to proceed by a series of stages. Each would involve creating part of the computer data base and operating as much of the total system as would be possible with the data available following each addition to the data base.

Following a full feasibility study it was recommended that a pilot system, covering only the first of the stages of implementation, should be set up in a small number of local offices. The primary purpose of the pilot would be to test the acceptability of the proposals to District staff and to discover the problems of on-line working.

An appropriate pilot system is now being designed.

2. The timetable for the total operation is approximately as follows:

Pilot system begins	Summer	1977
Evaluation report on pilot system	Autumn	1978
Decision to go ahead nationally	January	1979
National system Stage 1 begins	Spring	1981
Full national system completed	?	1986

It is impossible to predict with any certainty that these target dates will be achieved. There will almost certainly be unforeseen problems which cause delays somewhere along the line. All that can be said with certainty is that the total programme will take about a decade.

3. Major setbacks at this stage would be damaging to morale and to prospects of eventual success. (Our interest in computerisation dates from the late 'fifties and has already been subject to delays and frustrations.) So far as humanly possible the present momentum must be sustained and changes in tax structure absorbed as the programme continues to move. The successive phases of pilot and national staged implementation are such that they offer reasonable scope for flexibility. Whether the system will, however, be flexible enough to cope with LIT is uncertain. Much would depend on the form of the new tax. More serious are the difficulties of recruiting, training and housing staff for LIT since these in themselves are bound to hinder progress towards computerisation.

4. What has been said above shows clearly that any idea of moving rapidly (i.e. within say five or six years) *to a fully computerised PAYE system which incorporates LIT* is out of the question.

Whether LIT can be introduced within that time scale on a manual basis is a separate question, the answer to which depends on manpower requirements. Assuming for the moment that it can, what are the effects on the PAYE computerisation programme? A 1981 start for LIT, if otherwise practicable, would not prevent the pilot system from going ahead. Undoubtedly there would be problems in the years 1977 to 1979 arising from massive recruitment of staff, but it is reasonable to hope that for the limited number of Districts in the pilot system, the problems might be solved. (If rehousing were necessary then these problems would be much more difficult.)

If a necessary prerequisite for LIT in 1981 were a 1979 or 1980 start in simplifying the relief arrangements for Building Society interest and Life Assurance, then this too should not prevent the pilot system from going ahead. Implementation of Stage 1 of the national on-line system would, however, certainly have to be delayed. But this would not be a computer matter; staff could not be expected to cope with both major changes at once. It seems probable that a delay of two years could not be avoided. A 1982 start for LIT and a 1980 or 1981 start for the simplifications would ease matters for the pilot districts but it would again seem out of the question to start national on-line coverage in 1981. Assuming it would be necessary to wait two years to allow LIT to settle down before starting the national on-line programme then the total delay would be three years.

If LIT were to begin in 1983 then it might be possible to begin national on-line coverage in 1981. Part of the staff build-up for LIT might be used for some of the setting-up operations and the initial staff savings from the first stage of the on-line system might go a small way to reducing the total staff requirement for LIT. This, however, would depend very much on the ease or difficulty with which staff could cope with major changes in rapid succession, something which in turn depends on the final complexity of LIT and the lessons learned from the pilot system.

If LIT were introduced in 1984 or later then a start to national on-line coverage would become easier but to look so far into the future is unprofitable.

Oral Evidence by the Inland Revenue

FIRST SESSION - 11 JUNE 1975

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ORAL EVIDENCE—INLAND REVENUE

PRESENT

Mr F Layfield QC (Chairman)

Mr R Brain
Mr A L Bushnell
Dr E James
Dr G W Jones
Mr B Thornton Jones

Mr S H Wright
Mr I Yass (Secretary)
Mr J V Williams (Assistant Secretary)
Mr P T McIntosh (Director of Studies)

Representatives of the Inland Revenue

Mr N C Price (Chairman of the Board of Inland Revenue)
Mr J H Gracey (Under Secretary to the Board)
Mr B J Thomas (Assistant Secretary)

(Transcript of the Shorthand Notes of Snell & Son, 1 Middle Temple Lane,
London EC4Y 9AA and 2 Booth Street, Manchester M2 4AG)

Q: Mr Price, we are very conscious of imposing a lot of burdens on you in a year when you cannot be exactly idle, so we are particularly grateful for the amount of work which has gone into the papers you have been good enough to produce for us. We sympathise with you, in view of the pressures that must be exerted upon you at the moment.

We are also very conscious that this problem has been aired on quite a number of occasions previously and, perhaps rather over-optimistically, we think it might be of help to everybody if we are capable of bringing the matter to a decisive conclusion, one way or the other. That is optimistic, but we would not be here if we were not optimistic.

-A: We would welcome a decision on this, because it has been knocking at us for at least 20 years.

Q: We would like to start by looking at a number of the points you have raised in your paper, and I will ask my colleague to put the points we would like to canvass with you.

Q: I think we want to concentrate essentially on local income tax. Perhaps I should outline the points we would like to cover in varying degree this

afternoon. As I say, we would like to concentrate essentially on local income tax because that is where the pressure on us is coming.

Looking at local income tax from two postulates in terms of its function, one is to get rid of the rates. The other is substantially to increase the extent to which local authority expenditure can be financed from local taxation. These two things are not mutually exclusive, but the second implies substitution of LIT for grants; it could also imply substitution of LIT for rates as well, but the first is essentially concerned with getting rid of the rates. Curiously enough, the pressure on us is first and foremost in terms of getting rid of the rates, but that is the postulate.

The thing we do not particularly want to pursue, and which is covered in your paper, is variants on hypothecation; that is to say, a standard amount of income tax in terms of the yield—1p or 2p, or what-have-you—being simply in some sense hypothecated to local authorities. It seems to us that the thing only has real interest if it is variable at the will of the tax collecting local authority. It is that essentially which we want to examine and we would like to go over the ground on it. We would like to look at local administration.

We would like to pursue your points about self-assessment, if we may put it that way. We would like to pursue the manpower cost point.

Then there are three other subjects which are not local income related. One is whether there is a possibility of some kind of tax allowance or credit for rates. The second is what I call poll tax, and some people call surcharge; ie whether there is some way which might be administratively feasible of collecting a local tax from the earning non-ratepayer.

Finally, if there is time for it, we would like to hear your comments and general experience about Schedule A.

-A: The old Schedule A?

Q: Yes, which is now abolished, but which is of some interest in relation to rates.

I think that is really the range which we had hoped to cover. If we cannot cover it all this afternoon, we may hope to persuade you to return and see us again.

-A: Yes, certainly we would be very pleased to.

Q: That having been said, it is not easy to see where to start, but I would like to ask one general question to start with.

I have, to my colleagues, characterised the Inland Revenue report in these terms. In one sense it can be summarised as saying, on the subject of local income tax: "If that is what you wanted, you would not start from where you are." Because of that, we have some studies in progress about other people's local income tax, which we hope to study in the context of total systems in other countries. Would you like to comment rather generally on that?

-A: Yes. I think I see what is bothering you. It is what has always bothered your predecessors in this field. It is not generally comprehended, I think, outside the Inland Revenue, that in the vast majority of cases one does not have to arrive at a person's total income. This

distinguishes our income tax system from nearly every Continental system and the American system, where there is the concept that before one takes any action at all on levying tax, one gets together, in a tax office, all the bits and pieces of a person's income and then assesses that total.

Ever since income tax was introduced in this country in 1798 – and reintroduced in 1842 – the general structure has proceeded in quite a different way. The technical term used is that it is a 'schedular' system; that is to say, the legislation has said that there are certain kinds of income which shall be assessed, not a total income. There was, as you say, Schedule A in the first place, the notional assessment on ownership; Schedule B on occupation; Schedule C, interest from Government stock; and most important Schedules D and E, Schedule D for the self-employed and Schedule E for the employed person.

The general concept was that one assessed each of these by deduction of tax at source as it arose. This has now very largely disappeared, although the general approach still holds good. One has deduction of tax at source on dividends, on interest and formerly on the old Schedule A – the tenant deducting when paying rent to the landlord, whose liability it was.

As the income tax was originally devised without personal allowances on the one hand, and without higher rates on the other, if one got at the source of payment, and took the tax when the money was paid to the payee that was enough; one did not have to add all the bits of income together for any purpose.

Although we have moved a long way from that, because of surtax and other things which depend on total income, the basic concept of our system is still schedular and we, in the Inland Revenue, do not collect together all the bits and pieces of people's income except where that is necessary.

For this reason, it has been always easier for the Continental countries and the United States to say: "Such and such an individual has a total income of 10,000 dollars" – or whatever the total

is - "Let's take from that sum whatever is the proper measure of tax."

With the concept of this 10,000 dollars established, one can do other things with it, one of them, if you like, is to take a local tax.

Here we might say that a man has £2,000 salary and £400 from another source, say dividends. We do not have to add that £400 to the £2,000 which he gets from his earnings, which we can deal with separately under PAYE, nor to another £600 which he might get from rent. Those three sources of income are assessed separately and normally nobody ever adds them together and says, "That is a total of £3,000." It is because our whole administration is built on the basis of looking at separate parts, and not adding them together, that it is difficult for us to say: "That man has an income of so much; let us take something from that for his local income tax."

Q: We have a system where tax is withheld at source, and this is the historic process?

-A: Yes.

Q: Insofar as other people withhold tax at source, it is really advance payment, whereas you hope to get most of the tax by withholding it at source?

-A: Yes. You can see this illustrated by the taxation of dividends in this country and the taxation of dividends in France. In France there is a notional figure deducted from the dividend, which is essentially a payment on account of the man's eventual liability. In itself it is not necessarily related to any part of the personal tax structure, whereas here the deduction - called Advance Corporation Tax - is very deliberately designed in order that the rate of the ACT should be the same as the basic rate of income tax. So we do not have to look again at that man's tax unless he is liable to some higher rate of assessment or to repayment.

Q: The PAYE and the withholding of tax on dividend - these things fit together. The emphasis on a long band

basic rate of tax fits with it, because the administrative system begins to break down if that band gets narrower. Forgive me, but we have to explain these things in very simple terms when we come to write about them.

Two things follow from these related points. It seems to me that a long band, a system of deduction at source, whether it is for dividends or income, leads on to two questions. The first is: What happens if you have a non-cumulative PAYE, which is a concept which is not very easy for the non-specialist to understand. Could you elucidate it in terms of the tax credit scheme which the previous Government put forward and which at the moment we understand is moribund?

-A: Do you mind if I talk of the non-cumulative system within our present situation?

Q: All right.

-A: The general idea behind the invention of PAYE in 1943 was that we should have an arrangement whereby, as week succeeds week during the income tax year, the cumulative tax is always right and at the end of the year - the 52nd week - for the greater number of the cases, the correct liability of the individual has been paid. This is done by giving a code number which has the effect that the amount of allowances denoted by the code number, when divided by 52, or 12 for the monthly paid gives an amount of pay each week or month which is free of tax and it is the surplus over that free pay which is taxed. The free pay is the cumulative amount from the beginning of the tax year. The code numbers can be altered during the tax year, should a person become, for some reason, liable to pay a different amount of tax, but this is done normally in such a way that if, for instance, it gives a person more allowances, then in the week or month in which the new code number is applied it makes a correction for the tax for all the preceding weeks or months of the tax year, and runs through to the end of the year. We do not do this if the allowances are reduced for any

reason, because that would mean that the taxpayer has a very heavy tax deduction in the week of change which might even, in some circumstances, exceed his pay. In those circumstances we go on to a non-cumulative system, whereby each week or month one compares the free pay for that period only denoted by the code number with the man's actual pay, without referring to what happened in earlier weeks or months or what might happen afterwards, and the tax is deducted from the surplus for that week and for each succeeding week or month the same thing applies without taking into account any tax for the preceding period.

If you do this—if you have a non-cumulative system for the whole year or part of it—you must make an assessment on the person at the end of the year to determine how much overpayment or underpayment of tax has resulted.

I think the relevance of your question to our present problem is that if one makes an assessment one can be in a position to collect a local income tax. But in five-sixths of the cases which are dealt with on a cumulative basis, one does not have to make an assessment at all; one gets a return from the employer at the end of the year which says: "This man earned £3,000; I have deducted—" whatever the figure may be. That is the right amount and nothing more needs to be done.

Q: Five-sixths is approximately 84 per cent. Does this mean that 84 per cent of people are not liable for tax at higher than the basic rate and, insofar as they have investment income or unearned income, do not have investment in excess of the amount which would give rise to investment surcharge? If it does not mean that, what does it mean?

A: Under the unification system which was introduced in 1973, the PAYE tables automatically apply higher rates.

Q: I see—to unearned income?

A: If there is other income—dividends, building society interest, or anything of that kind—one has to make an

assessment on that, to bring it in at the higher rate.

Q: What are the characteristics of the 15 per cent or 16 per cent?

A: A number of different things. Can I give an example which caused the 16 per cent two years ago to go up quite considerably? Building societies altered their rates of interest charged during the course of 1973-74. I think they went up from 8 to 11 per cent. This meant that all the codings which had been given 18 months before to people who had a mortgage would be derived from the building society's estimate of the interest payable which would be based on 8 per cent. In fact, practically everybody was paying for part of the year at 11 per cent and were therefore entitled to more relief than that given in the code. We had to make 600,000 repayments at the end of the year because the coding had not worked to give an accurate result, because we did not know what the right interest was. Therefore, assessments had to be made, which threw up these overpayments. The percentage of assessments was rather higher in 1973-74 than the 16 for that reason.

Another example might be that we had given someone a child allowance and then discovered that the child had earned in the year more than £115 below which the full allowance is given and above which it is not. We discover this later and have to make an assessment to put it right.

Q: I think you have seen the little scheme which we sent to you?

A: Yes.

Q: Turning to Sub-section (b), "Codings and Deductions by Employers", as I think it was explained in the covering letter, the suggestions in this two-way note are intended as a way of smoking things out and helping to get to the root of things. What about paragraph 6 of that? How far could that make sense?

A: This is the "Place of Residence"?

Q: Yes.

-A: I think the answer to all these things is that the coding would be quite possible to evolve. It is both coding and a tax-table which we would be using. It is necessary to distinguish these two things. There are two matters one has to consider. There is first of all the free pay which a person can enjoy before he gets taxed. Now the point of a code number is to determine the free pay. It is an expression of the man's allowances during the year. Having got that, you then eliminate, by week or by month, the pay which is free of tax and then you look at the rest: that which is taxable. A code number does not tell you anything at all about the amount which is taxable. The amount which is taxable is derived from a tax table which an employer has, which we devise, reflecting the basic rate and higher rates.

It would be conceivable – it would be difficult but conceivable – that each employer should get from us first a code number which gave the free pay and also a series of tax tables, one of which, to give an illustration, would charge tax at 35 per cent, the current rate, another set 38 per cent, another set 41 per cent. He should then be led, by information sent to him, to use one or other of these tax tables depending upon where the person was deemed to live at whatever was the relevant date. That, I think, is conceivable but it does mean heavy extra costs in printing and employers' time.

Q: You are saying, as I understand it, that the proposition in (b) 6 makes sense up to a point, in the sense that it could be made to work if there were four possible levels of local income tax. If you had four possible levels, including nought, does this mean you would have to have four sets of tax tables instead of one now?

-A: One could, I suppose, instead give the employer some sort of ready reckoner – 1 per cent, 2 per cent, 3 per cent, 4 per cent – and tell him to look first at the national tax table, second at this extra ready reckoner, then add the two together and put the sum of the

two in the tax column on the deduction card.

Q: Let us assume they can be got to do this, with the cost that it entails, whatever that happened to be. Is there any reason to believe – whatever the percentage now is; 16 per cent – that if that particular coding antic could be done, the 16 per cent would go up?

-A: I do not think so, not if your residence position was determined sometime before and not capable of being altered. Difficulties could arise if the scheme devised said that if the man moved at some time during the year, both local authorities became entitled to some tax. If the scheme fixed the residence as the one some date before the tax year, I do not think you would increase the 16 per cent. You said, "Let's assume that can be done". Please don't forget we are dealing with ICI on the one hand and a Cumbrian hill farmer on the other hand; it is much easier to tell the Cumbrian hill farmer: "Use the red book", rather than ask him to work out a percentage.

Q: Can I take one point. When you answered the first of our points at (b) 6, you said, "Given the other tax tables". I was not quite sure what you connoted about that. You mean, on the assumption that the exercise sets out?

-A: Yes.

-A: Could I make one point on the number who would have to be assessed. If one did have this sort of system, it would make it much more difficult to set the adjustment for collecting an underpayment, because there would be a variable rate. If, in October, the place where the man lived was known to us and what the rate was going to be for that area, then we could make a better estimate. If it was not, we could get the under-payment adjustment wrong, and that would mean more cases for assessment at the end of the year.

Q: And possibly more cases for paying by cheque, I suppose?

-A: We generally try to collect arrears through Pay As You Earn, but I think

we might have to think again and go for direct collection in more cases.

Q: If you knew say in October at what rate a man was liable to in the forthcoming year, you could make a better stab at it?

-A: That is right.

Q: There is no problem about it being any worse than the present system?

-A: No. To some extent it would be better. We do not now know the basic rate of income tax in October, of course! I take it that our reference to the "under-payment" is generally understood, is it? We use the code number for all sorts of funny things apart from personal allowances. If somebody has made an under-payment of tax in the previous year, we adjust the coding so that, in effect, by reducing the personal allowances we can recover the under-payment.

Q: Why would the knowledge that you had of the local authority rate in October make the difference?

-A: We collect the under-payment by, as we would say, reducing his allowances so that he pays tax on more pounds per week. If we are to get a certain amount of money out of somebody in this way, we need to know at what rate he is going to be taxed. If that alters we must make a different adjustment.

Q: So you know how much you have to alter his marginal rate?

-A: Well, we know how much we have to collect.

Q: We are not so used to this as you are, so let us take a more general point. I would like to take the point that seems to arise out of the basic rate situation. As you rightly remind us, with the unification of the tax structure getting rid of surtax, as far as PAYE is concerned you pick up the steps in the arrangement in a way which you did not do when the surtax had to be charged separately, and this was a simplification.

-A: That is right.

Q: Therefore, it would seem to follow that the length of the basic rate—the long basic rate—

-A: £4,500.

Q: . . . is desirable now, in strictly administrative terms at this point, mainly in relation to deduction at source on dividend income and such kinds of income as are also subject to deduction at source.

One of the problems about a local income tax on the face of it is that the first step in the British tax system is so high. I am referring to the step from nought to 35, where we are now, or virtually 40, if you add in National Insurance contributions at round about the same point. That step is very high already and if a local income tax were in substitution for the rates, and if it were not offset by the central government reducing its income tax and putting more on indirect taxation, then that step would be very significantly increased. Are we right in thinking: How far is the administrative need for a long span of income—£4,500 now, I think, at the basic rate—related to unearned investment income? Is there any way out of this situation, because there is an important point about the first step as well as subsequent steps?

-A: I think that is right. It is related mainly to unearned income; if we were concerned simply with PAYE income it would be easier, but still not easy, to have a much more progressive scale. There would be difficulties about this, particularly with the husband and wife both working; that sort of thing.

This unusually long band is retained partly for administrative reasons (I think there are political reasons as well) in order that one can have as large a number of people as possible for whom deduction of tax at the present basic rate determines finally the liability and there is no further adjustment to make.

Q: To bring as many earners of income into the net as possible—into PAYE?

-A: Yes.

Q: In a way, there are two kinds of disincentive effects. One is the disincentive to pay taxes – one of the postulates for local income tax – and the other is what might be argued as being the disincentive to work.

I think we would be quite interested to hear your views about the so-called taxable capacity point, and what the strains on the system are. First of all, the first step is now very high indeed by historical standards. What would be the effect if that went up? Secondly, further up the steps, we would be interested to hear whether you have any views. On the broader second economic point, I think we would be quite interested to hear, but I think the first is much more within your area of competence, as the French say – not suggesting that you are incompetent in any way, of course.

-A: It is a very, very difficult question to answer. I think it is just not capable of being measured in any way. One measures it only by the degree of protest that one has. That is some sort of measure I think. We cannot tell how much tax is evaded – one cannot know the unknowable – but I think there are certain signs that now evasion has reached a point that is very serious indeed. The measure which I feel is the best is the success of our special enquiry units who look into the misstatements of the self-employed or companies. Under PAYE one is a captive to tax and there is little escaping, but I am now talking about the field where there is some option about whether one declares or not. It is interesting to see that, compared with about 10 or 12 years ago, those special units are not collecting much more tax – something like £16,000,000 – than they were all that time ago. Yet all the rates have gone up, and look at what has happened to incomes! It is quite extraordinary. There are as many people at least engaged in this work, yet one feels that there is much more there that they could get at. It is these imponderables that I

think are the only real measure. If one takes what were regarded as very, very high rates indeed during the War – when, if you remember, the standard rate went up to 10/- – there was still, nevertheless, some rebate, which was thought to be a real one in those days: the Post-War credit. What is more, there was a fairly long band at which the tax was charged at 6/6d, which for most people brought down the average. Now, as you point out, we have a basic rate of 7/- and another 1/- on top of that for National Insurance contributions. If one is thinking in terms of yet another 1/- for a local income tax, we are getting very high indeed.

Another I should have mentioned was that the 10/- rate during the War was mitigated, because we had an earned income allowance which meant effectively that the rate was 9/-. So we are now back to something like the rate during the War for most people, which was regarded as very high indeed. There is, in my view, a serious risk of increasing the amount of evasion.

Q: It does not follow that any of these alternatives are being canvassed. If we leave aside the administration costs, it does not follow that, of itself, it would necessarily put up the income tax by any perceptible amount if, at the same time, the amount available globally to the local authorities were not permitted to rise. It would be a transfer?

-A: Yes.

Q: It would depend on two things, therefore: that the administrative costs did not become so material as to upset that element; and ensuring that the total expenditure over all the things for which the money was being used did not rise materially. Clearly, there are risks.

-A: That is right. To replace the domestic rate would mean another 5p, and the complete replacement of all rates is something a good deal higher – 12p on existing figures.

Q: It may be said that the real purpose of local income tax would be to

increase the extent to which a given level of expenditure could be financed from local taxation. Well, let us narrow that down a bit and say that it is a local income tax coming in alongside rates, or narrow it even further and say that, all right, the object would not be to reduce the rate, it would be to reduce grant.

-A: Yes.

Q: Now in those circumstances the first assumption about what the national authorities might do is simply to reduce the rates of national income tax to compensate. Now this would compensate on average. Of course, it would not compensate specifically area by area to the same extent. I think I would guess that at the outset the difference in rates area by area might not be very great, though of course it might expand in time. Do you see problems arising from central government and the local authorities — whoever they are for this purpose — having access to the same tax base? I ask this question now in the broader sense, though I think we would like to have the administrative aspects of it.

-A: I think there would be possibly some constraint on the Chancellor in fixing the basic rate, because he would know that there was something to be added to it. I do not know precisely how Chancellors' minds work, although I expect you are privy to seeing some of them operating. There is a tendency I think, particularly in times like this, to come to an assessment of the basic rate by saying: "How much can the country stand?" I think there is, in the Chancellor's mind, a sort of optimum increase that he might ask for. I would have thought that the fact that he could not go quite up to that because the local authorities were also going to have a bite at the same piece, could be a constraint.

Q: To ask a more leading question about the marginal rate, probably it is useful to go over the ground about the length of the basic rate and the height of the step. There are really two things here. The first is that for instance we

are told that in Sweden the combination of the local and the national tax produces a marginal tax rate for the average wage earner in the area of 60/65 per cent. It is still true in this country that the marginal tax rate for the average wage earner is the basic rate plus, if you like, the National Insurance contribution. As we have yet to hear in depth about Sweden, we do not quite know whether this produces other strains or not. Nevertheless, it is a very interesting fact.

The later question is: If one were trying to beat some of the problems of a local income tax, would not one beat some of them if we did not have this enormous £4,500 band and the first band was at a much lower rate?

-A: We have been going into the costs of something like this. There is a general pressure for reintroducing some form of reduced rate band at which people would enter tax, and the cost of doing this is something enormous.

-A: I do not have a figure — I can let you have one if you like — but the real problem is that so much of taxable income is concentrated at the bottom of the scale. Something like three-quarters of the total is in the first £2,000. So, if you make the first slice taxable at a lower rate, it is, by itself, assuming you keep the same starting point for tax, monstrously expensive.

Q: Something like three-quarters of the tax?

-A: No, something like three-quarters of taxable income is in the first £2,000. That is not the exact figure, but it is of that order. This does make it very expensive to do anything at the bottom.

Q: What do you mean by 'expensive'?

-A: If you leave the basic rate unchanged, you lose an awful lot of revenue.

Q: At the moment, with such a high rate of inflation, in some ways, would not one be wishing to escalate all the bands roughly in line with inflation? I

suppose, if you did that, you would make the problem even bigger?

-A: That is true.

-A: Can I add another point to what has been said? Because of the expense - we can let you have that - it does mean that for anything that one would think a Chancellor could readily accept, the band would be quite a short one - I am thinking in terms of £100-£200; that sort of thing. But the point of a reduced rate band is to let people pay at that rate on their marginal income. If that is not accomplished, you might just as well reduce the basic rate, anyway. You are not going to get many people whose income finishes within the narrow band which is all you can create. They are paying marginally at 35 per cent, so why not drop it to 34 per cent? That is an argument that is put.

Q: And raise the personal allowances?

-A: Yes.

Q: Your point is in one sense arithmetic and in another sense slightly Irish, because one is after, in pursuing this issue, the problem of the marginal rate and the disincentive. First of all, you do get more evasion if you have steep steps; and the second point is the disincentive in terms of work.

-A: I do not think evasion is a product of steep steps; it is a product of high rates.

Q: Perhaps we should come back to the question of administration. I think this is a question that is useful on a basic rate concept. I think we would like to dodge about a bit between the two, because I think we all find that our minds begin to split on the administration of the tax system, because we do not talk about it every day. Postulating, as we have done, local income tax which is variable locally, there is a special problem, which you have identified in your paper, about unearned income. I wonder if you would like to develop that for us and remind us of it. Forgive me, I think some of us read it when we first received your report and others more

recently. How do you see the essence of the argument, the essence of the problem, about unearned income in relation to a locally determined local income tax?

-A: I think in principle the matter is fairly clear. If a resident within a local authority has unearned income, one would have thought he should pay the local authority rate of local income tax on it. The difficulty is wholly an administrative one. At a time when you do not make any assessment on the great majority of such people in respect of unearned income - you might make an assessment on other grounds - you would have an enormous administrative apparatus in order to bring that local tax into payment.

Now I agree that on the scheme that you were kind enough to send us, an endeavour was made to meet this point by a composite rate deduction from dividends and the like. I think this brings its own troubles. The first is that a composite rate deduction would presumably be something less than the maximum one could envisage allowing any local authority to charge. If one said a local authority could charge up to 5p, the composite rate presumably would be in terms of 2p-3p rather than 5p.

Q: It would certainly be some sort of average or norm of something.

-A: That is right. In the 5p local authority area that could, as between two individuals, be rather rough. One might have two people living next to one another; one earning, who, because PAYE was relatively easy to collect, was paying at 5p; the other living on investment income and only paying the composite rate of 3p, because one was not bringing the extra 2p into charge. I think that would be the first difficulty.

There is another problem, in that a good deal of untaxed unearned income is dealt with through PAYE by restricting personal allowances. If one has £100 of Bank interest, say, and one is in employment, the way we collect tax on that £100 is to restrict the personal allowance given in the coding by 100.

Then one collects tax, in effect, on the unearned Bank interest through PAYE.

Q: You are in arrears, as it were?

-A: Well, it might be arrears or an estimate, of course, but however it is done tax would then be collected, in my example, at 5p, whereas the Bank interest, or the unearned interest, of the next door neighbour would be only at 3p. There is some sort of inequity there.

Q: I do not want to defend this suggestion, but let me pose two consequences. On the first point, of the inequity of the unearned income, they already are rather different animals, and that is recognised, for example, in the way personal allowances are allowed, and again there can be a difference, in tax rates one against the other.

-A: That is not exactly right, if I may say so. The only difference is if the investment income is above £1,000, when there is a special investment income surcharge.

Q: I meant in that sense. Secondly, on the point of picking up the tax on the non-taxed income, we established earlier that in the same way as you could repay under-payments for previous years, provided you knew by the 1st October the appropriate local rate to apply, you could do things with the coding. I assume the same sort of principle could be applied to non-taxed dividends?

-A: I think, if one were dealing with one case, yes, but the idea of fiddling about with 21,000,000 cases is a bit daunting. But I take your point, yes, in theory one could do that.

To go back to your first point, one is rather reversing the social role of earned and unearned income in terms of what seems to be the contemporary view: earned income good, unearned income nasty. In one area you are doing it that way by the composite but in another you are reversing it.

Q: You are going through two steps, not exactly bringing them into parity. You are ducking the issue?

-A: Yes.

Q: You would as regards half of them, but one has an area of choice here. The Government could well decide to pitch it higher above the average; to pitch it where they want it. If it were the only thing standing in the way of a system of local income tax, it would be better than nothing. There is a bit of rough justice about it, but how rough you make the justice is a matter, presumably, of some sort of political decision, is it not?

Q: I think we interrupted you. Your first point was equity.

-A: I think the second one was the inequity between the two different types of income, with one chap coded in and the other directly assessed.

-A: Another point worth mentioning is that investment income tends to be concentrated amongst older people and, with the higher starting point for older people, you have a fair number who have a pension and a little investment income. I think one would be bound to repay those below the threshold at the composite rate, not just the basic rate. All the tax deducted at source would have to be repaid if the man were exempt. And there are other cases, eg pension funds, which are quite large holders of investment income, which would also have to be repaid, I would think. One would have to keep some sort of record of this, to find out how much had been collected and how much was left. No doubt one could use sampling techniques for this.

Q: There is no point in having a long argument about what is equitable. On equity we hope you are reflecting the pressures on you.

-A: This is right, but I would not like you to under-estimate them.

Q: This is what we want to identify.

-A: If I may say so, anybody who did try to run a system which people thought was inequitable would find the wheels very truly clogged by all the correspondence it got.

Q: I suppose what we are saying on unearned income is: Having taken the point, we think that there would be an administrative problem if you were to try to relate, as it were, a person's unearned income to his place of residence and therefore collect the appropriate amount - whatever it was; 2p, 3p or 4p - for that area.

Perhaps we ought to go back to that administrative point. Do we then say, "All right, if that is a very difficult and costly administrative problem, then perhaps one could deal with it in some by-and-large way, and there would be a judgment to be made by politicians about it."

On the second point, I think you have told us of a particular administrative problem that could arise there, but on that point I think we are really after what your feeling is about the pressures on the system, looking at it strictly as a tax collector, as opposed to another system. Your fear about what people deem to be inequitable is whether it makes it more difficult for you to collect the taxes that it is prescribed for you to collect.

Perhaps we ought to go back to the first question. I am trying to narrow out the range. What is important from our point of view on the administrative side is whether there are certain kinds of inequity, or deemed inequity, which impinge on your collecting tax.

-A: I think we have made the main point on this.

Q: Can I ask one further question. Supposing one were to take this point in two stages, to start on the composite rate, particularly if it were a relatively low composite rate, and at a later stage move on to incorporating the full system. Would that make any material difference to the administrative obstacles?

-A: I do not think so. I think I ought to say quite generally about this that it is easy for all of us to sit round here and have the picture of a company in which we hold investments, sending us dividends, with taxes deducted from them, in effect, not at 35 per cent but

at 38 per cent. There are other problems - quite a lot of them. There would be some foreign investors who have shares in that company where the 38 per cent has been deducted. One has to do something about that. They ought to bear, presumably, the income tax. But somehow we have got to get the machinery to repay the 3p, because there is no reason for them to pay a local income tax.

Q: I am not quite sure I follow that.

-A: What a company is doing is this.

When it pays dividends, if it is to deduct tax at this composite rate, it will send the amount due to you after deduction of tax at 38 per cent, that is the 35 per cent national basic rate plus the 3 per cent local authority composite rate. When the company does its own tax calculations, it will forget the 3 per cent. It will only allow against its own Corporation Tax, the 35 per cent advance Corporation Tax, as it does now.

Thinking now of the recipients of the dividends, so long as they are in this country, this is all right - they have paid their local income tax at the composite rate, and this is fine - but there will be some in America, some in France, and all over the world, who will have had this tax deducted at 38 per cent. There is no reason whatsoever why a citizen in New York should be paying the extra 3p local authority tax, and he ought to be repaid it.

Q: I do not quite follow that. The man in New York pays his 35 per cent?

-A: Yes, but he has had tax deducted at 38 per cent.

Q: The 38 per cent now becomes a direct local tax at the composite rate, as opposed to going through the grant system?

-A: I was interested in the 3p.

Q: All right, let us take it at 3p, and let it be in addition to the 35p. I do not really see why, just as the Americans now pay some national taxes to the UK

they should not pay some part in local taxes.

Q: I am sorry, I think they are two different questions, because there are two different thoughts buried in this paragraph of the statement. Because of the administrative problems of varying a tax on investment income according to residence, you simply take what you think the average of the local tax is — let us take it at 3p, as an example — and you say: "All right, in order to preserve very, very crudely the existing desired status quo between unearned and earned income, we will add that average — namely, the 3p — to the investment surcharge." That is one way of doing it, and that is the crudest of all.

The second one is where you take this 3p, or whatever it is, you call it "local income tax", and you distribute it to the local authorities.

Both these, it seems to me, raise this question. What happens to the Corporation rate under an ACT system? It has only struck me, listening now, that this is a very serious point. The second is that the problem of your New York shareholder in a UK company, I think, differs a little philosophically according to which of these two concepts are taken. Equally so does the position of the pension fund, which is not chargeable to income tax. Have I identified the question, because I thought we were beginning to get at cross-purposes? Do these questions make sense?

-A: Can I clear up the ACT issue first? I think this will be all right on the basis of 35 plus 3. The company would still set off 35 against its ultimate Corporation Tax liability. 3p would be deducted from all the dividends, and the company would simply be acting as collector in respect of the 3p. There would be no set-off against Corporation Tax, but we are concerned with the withholding tax.

Q: What about your non-resident in this case?

-A: I think the non-resident would take the line strongly that he pays state tax to New York State and he does not see

why he should have to pay local tax to anybody in this country.

Q: What would be the position if one abolished all local taxation and put up the basic rate from 38 to 47, shall we say? Then the chap in New York would have no come-back, would he?

-A: It is identifying something as a local tax which is awkward. Of course, if you abolished all local tax altogether, I agree with what you say, but describing something as raised for local services would be very awkward, I think.

Q: Would it be practicable to require companies to levy 3p only on residents of the United Kingdom?

-A: But you may very well have American shareholders with UK addresses or holding through UK nominees.

Q: There is a real problem here, and it has only struck me as I was listening, and it is not easy to see the answer. If you wanted a crude answer on unearned income, it seems to point just to saying that it is not going to be a local tax at all, and the Chancellor would then say: "Taking account of the fact that we are going to have a minimum standard of unearned income, it is my intention to raise a national surcharge on unearned income." Whether that would be tenable or not is a matter of judgment.

Q: It is a presentation point.

-A: Yes. I was just wondering about building societies, who pay a composite rate, or dividends. So you would have a composite rate on a composite rate.

Q: Before we leave this question of equity, can I ask a question which has some bearing on it? Recently, since inflation started to reach its present level, there has been a new theme in the protest against the 'discrimination' against unearned income, namely, that persons employed in the public sector with inflationable pensions have something of capital value which is incalculable. I do not want to deal with the merits of the argument at all, but is this

something which you feel or suspect will become reflected in any greater reluctance on the part of those who have to declare investment incomes to conform to the letter of the law?

-A: I do not think so. I do not think people who want not to pay tax are seeking any extra excuse.

Q: One of the themes in your report is that on many possible grounds you have a cash flow problem, and cash flow is terribly important to local authorities. Until relatively recent times, one of the attractions of rates was that not only was the amount predictable, but there was a predictable rate at which people would pay. You knew, roughly speaking, not only what the sum was that you had to collect, but roughly when it would come in. It may be that, because of the state of excitement about the rates, that is not quite predictable at the moment as it once was. In your report, you point to a problem about timing, but I thought that was largely contingent on the problem of assessment. If one could beat the assessment problem along the lines of this crude note, would there be a real timing problem?

-A: I would have thought that the large sums of money, which local authorities are really concerned about, would flow fairly regularly and in a timely way. The two big income producers for us are, of course, PAYE and Advance Corporation Tax. PAYE comes in every month, on the 19th of the month following the month in which the tax is deducted from the employee's wages. If one imagines having a system where the tax deduction is enhanced by some local authority rate, then the collector would receive these sums and, presumably, by some arithmetic or by the figure being shown separately on the chit sent in by the employer, would then be able to say that so much was due to local authorities in the aggregate. Now, the difficulty would be the collector had to split it up between them. On the scheme that we evolved there is no identification between the actual receipt, on the one hand, and the pound notes which go to the local authority, on the other. There

is a discontinuity. On that basis, you could have some payment on account quite regularly to local authorities. Similarly, when the money comes in from Advance Corporation Tax, one could split it up in some sort of way and, as it were, keep the local authorities going. The clearing up might be difficult at the end of the year, but one imagines that, in terms of money, there would be nothing in it.

Q: If there is no need to have positive identification each month, one could go on last year's capacity.

-A: Yes, I agree. One of the difficulties we foresaw on timing, when we were not going along your road, was the case where liability takes an awful long time to settle. One has back duty cases, where it is quite possible to have to go back 20 to 25 years to get the right tax. In a less dramatic way, a lot of businesses do not get their liabilities settled for a year, 18 months or two years after the assessment is made. If one was always identifying specific sums with specific local authorities, there would be a problem, but that, I agree, is circumvented by your procedure.

Q: Under what I will call our cock-shy, I suppose there is not any real reason why you should not have even monthly transfers once you have identified them?

-A: No.

Q: One is troubled about the timing problem in two respects: one is unpredictability, and the other is the enormous financing gap in the transition, but it does not look as though this would be absolutely major?

-A: No. I think that without identification one solves a lot of problems; not all of them, but a lot. If one can picture an employer in central London, for example, who was employing a large number of people drawn from all the London Boroughs, then one can imagine having a return from him saying: "Here is your ordinary PAYE, and I have deducted so much for Hillingdon, so much for Croydon and so much for

somebody else," by reference to the employee's residences where they could be ascertained. Each month there would be a list of this kind, and the collector would be sending out ascertained dollops of money to these various authorities. If, on the other hand, one simply said: "Here is some money. Here is something which does not necessarily add up to what I have collected but is near enough" there is a transition from accuracy into something that is not accuracy. That may not be popular.

Q: I am sure we must come back to the question of residence, and can we just take the other main category of tax payer, who by presumption would pay local income tax, namely, the self-employed under Schedule D. Here, in any case, the self-employed are for the most part within your 15 to 16 per cent, I take it?

-A: Oh no. The 15 to 16 per cent is entirely PAYE. Self-employed are not in PAYE.

Q: That relates not to all tax payers, but to PAYE payers?

-A: Yes.

-A: It does not follow that, because a man is not under PAYE, we make a total income assessment. We make an assessment, but there is no need to calculate the total income.

Q: Does that matter?

-A: There is an assessment, but it does not have to be a total income one. We do not care whether the dividends paid to him are £200 or £500 as long as one can see that they are not enough to make him liable for surtax.

Q: So, assuming we have got a man with £10,000 a year earned income and, say, £20,000 a year investment income, if he were in an authority where they were actually levying a rate up to your maximum of 5p, would it mean that he would have 3p deducted at source on all his £20,000 and 5p on his £10,000?

-A: Yes.

Q: You say that for a lot of the

people under Schedule D you do not have to do what you described as a total income assessment?

-A: No, I did not say a lot; I said it does not necessarily follow.

Q: I see, but if you had a local income tax, would you need to? Would that change the situation?

-A: It would depend on what you did. If you had a man with profits of £3,000 plus an investment income of £500, we would now make an assessment on £3,000, not £3,500. As long as the income is not coming within the higher rates region it does not really matter to us whether he has declared £500 or £450. Somehow, unless one goes on this composite rate basis, on the assumption that he is paying the same local authority rate for his whole income, one would have to get an assessment on £3,500. If one is going on this composite rate basis, then, as with your £10,000 and £20,000, he would pay 5p on his £3,000 and by deduction 3p on his £500, and an assessment on £3,500 would not then be necessary. It would only be necessary if you wanted the same rate over the whole of his income.

Q: Would not the 3p have been deducted at source?

-A: Yes. You would only have to make it up if you said that he had to pay 5p over the whole of his income, and then you would have to get the extra 2p.

Q: Would it involve an awful lot more work?

-A: There are one and a half million assessments under Schedule D each year.

Q: But most of the work is involved in looking into the profits of businesses. The investment income would be just an extra, which people will presumably give the correct amount, or the tax will have been taken off at source.

-A: That is true; but the point you have got to answer before that is where is he paying it? If his business is, shall we say, in London where he has a lock-up

shop and he lives in Essex, where does he pay it?

Q: That is another problem.

-A: Yes. I do not know how the argument would go, but if one said that he paid for the services he got for his lock-up shop from his income from the shop in the London Borough, since his investment income related to his residence, then the local authority tax on that ought to go to Essex. So you would want an assessment of £3,000 for London and, unless the composite rate took care of it, an assessment of £500 for Essex.

Q: Can we leave the double residence point for the moment. I see the complications involved there. In any case, it is inherent in the problem of residence, anyway. Going back to the assessment point and following on the point about how difficult it would be, once you had achieved the state where you knew the residence of the local taxpayer and taking my £10,000 and £20,000 case for illustration, on the assumption that you were rightly making a moment or two ago that, at any rate, at a certain level it would be desirable to top up the 3p to bring it up to the rate levied in the locality, you would have no difficulty on the £10,000 earned income, because you would get deducted at source 3p on the composite rate, but then you would have the problem to raise of saying: "I am asked to ensure that in respect of the £20,000 I collect another 2p. So at some moment I have got to take the two sums into account together." Would not they at some point in time marry up, because the dividends would be known to you as being paid to that resident and providing it was not essential to the authority to have it at that moment, it could be done some considerable time later. Would it be very difficult?

-A: No, particularly in that type of case, because a man who has got a total income of £30,000 we certainly would be assessing. In fact, we would be assessing him three times: once on Schedule D, higher rates once on his

investment income, and then investment income surcharge. So, for that chap, I think we would agree that there would be little extra work in adding on whether it is 5p or 2p to top up.

Q: Of our one and a half million, is he a typical case or does he represent a minority or majority?

-A: A very small minority. We have not got the figures with us but it is the constant complaint of our Staff Association that a huge proportion of Schedule D payers are on something less than £4,000 a year. There are, we think, good reasons for it, but it is the case that the great preponderance of them are being assessed on comparatively small figures.

Q: I think I have missed something. If the majority of them have less than £4,000 a year - is that taxable income?

-A: No; Schedule D income, the actual profits.

Q: In these circumstances, your problem essentially is which of the rates of LIT to add on. It is not a problem of total assessment.

Q: Provided there is no urgency.

Q: Yes.

-A: I do not think we are terribly worried about the Schedule D field of this, because, on the whole, we know where these taxpayers are at any particular time whereas we do not always know with PAYE. That is the first thing, and the second thing is that we make some sort of assessment on them, and thirdly compared with PAYE they represent a very small proportion.

Q: Just so that I can be clear, that means if we include the topping up exercise to bring the composite rate up? Your comment includes that?

-A: Yes, but it would mean more work.

Q: I think that probably brings us to the whole question of residence. I know this ground has been gone over a number of times before, but it is absolutely essential. Provided there was no

rush to put it in, that it was a long-term proposal and the old system was going to be used until the new one was ready, is it really going to be very difficult to change over or to run parallel, whichever is the appropriate point, the place of residence?

-A: The main difficulty about place of residence is that we issue to a very large proportion of PAYE taxpayers a return only every three years. So that at any time we might be that length of time out of date on the place where they live, their residence, and the number of changes of residence—not, I agree, always to another local authority—is quite high.

-A: The number of changes is about 2,000,000 a year.

Q: 2,000,000 out of?

-A: Something like 20,000,000.

-A: So we have a three years' lag where we are at risk of being out of date with our records over a fairly large area.

Q: Could I just analyse that a bit? Is that by implication saying that is the major problem, or is it by implication saying it is the only major problem?

-A: I think it is a very large problem.

Q: Could I put the question another way? If that were thought not to be a problem, would the matter of residence, given an appropriate period of time, then be regarded as a serious difficulty?

-A: No, I do not think it would.

Q: Then can we look at it? It would only matter, would it not, to the degree to which the migrations crossed local authority frontiers?

-A: Yes.

Q: That would mean a high rate of net migrations continuing into certain areas or out of certain areas. I say "net migrations", because the fact that 100,000 people left the London area and 100,000 came into it would not necessarily disturb the local authority in terms of receiving income tax.

-A: No, but it might disturb 100,000 people, because they might think they

were being charged more than they should be.

Q: Yes, because of the difference in rate. There is no way, I suppose, at the moment, is there, of deciding how much of the 2 out of the 20,000,000 is an inter-local authority move in county terms?

-A: We can get these figures from the Department of the Environment.

-A: I do not think they can provide them.

Q: I suppose one would first want to know whether the net migration movements of the last 20 years are continuing just as absolute figures?

-A: Yes, I think all this is true. One can minimise these figures quite substantially and, in that sense, it does not matter terribly how much each local authority gets, because the total would be about right. That is not really our worry. Our worry, as I have said, is dealing with the individual, creating correspondence, creating work.

Q: But in a sense one can slim it down further, can one not? You are not going to have to worry about the chap, who goes from London paying 3p and arrives in Manchester where the rate is 5p, and still finds that he is being asked for 3p. He is not going to make a very vigorous complaint, is he?

-A: No, he will not complain. He might complain if we follow him up later, when we discover he has moved.

Q: This depends on how you operate the system. Now, thinking of the person who moves from an authority with a high rate to one where he reckons he should be paying a lower rate, suppose we make it his obligation to let you know as soon as he moves? If I think you owe me money, I am quite quick to write to you, but if I think you are after me for money, I am not quite so quick to write.

-A: Yes, that is not uncommon. I think the trouble here would be that he would not write until the tax had begun to be deducted, although he had moved two years before and although he had got

a code number. Nobody takes any action until they start suffering actual money ss. So we would be in the year itself d I think the trouble here would be, uld it not, in trying to adjust the de number. We could not get it right a cumulative basis. No; I'm sorry, I nink this one would be all right. We could deal with that one on a cumulative basis even if he notified us after the year had begun.

Q: It is the same as someone announcing that they have an extra child sometime after it is born?

-A: Yes. If the rate goes up we do have difficulties, but that one is all right.

Q: The only main source of anxiety qua the question of residence, given an appropriate period of time to establish it, lies in some unknown proportion of the 2,000,000 out of the 20,000,000 who do not move inside one authority, but move to another authority, and of that reduced figure, whatever it may be, it does not apply to that class who move from an authority with the same rate. It would not rub so much, so far as you are concerned, at any rate, to the chap who goes from a low rate authority to a higher rate authority, because he is not the chap who is complaining, and, in any case, you can deal with him later. So that is the third rub. It is the fourth element, the unknown quantity out of the 2,000,000, where a person moves from a high rate authority to a lower rate authority and thinks he should be duly assessed or pay on the lower rate. Of the 20,000,000, do we know—I am looking to see how big the scale is—how many are in your 1½ million, who are Schedule D and who do not have this problem?

-A: We do not know, but I would have thought it is the Schedule E people who are peripatetic.

Q: I assume there must be some kind of discount for that, because if you take an accountant, or somebody who is self-employed in a partnership, they do tend to move from one area to another. So, although the fifth element of dis-

count is small, there is some element?

-A: Yes.

Q: Have we any way of knowing, when we have taken those five elements into account, what sort of order of magnitude of the 2,000,000 we might be talking about?

-A: I do not think we have any breakdown of the figures.

Q: If, after taking into account all those five discounts, it produced 1½ million, it would not make a very significant difference to the problem, but if they turned out to be one-half or more, it could be very different. I do not know at all.

-A: You have disposed of a number of our difficulties under five heads, but I am not quite sure whether one can dispose of them quite as quickly as that, because our experience is that people do not really know. They do not know that 35 per cent is the basic rate, and they certainly would not know, moving from one area to another, that they were being charged 3p and they are now being charged 5p. So the first thing they do is to ask, and this sets up correspondence and work. I did feel that on the way you were approaching this, you were saying that we could ignore these people and those people, because they would look after themselves; but they will not, and we will have to do a lot of work for them.

Q: I accept that there are other things, including the back pay point, but I was trying to see how serious each step was in terms of its magnitude. Of course, there will be difficulties in any new system, but I was trying to get a sense of the scale of your worries against what we believe to be the benefits. It seems to me, looking at the population first, that the initial worry is the element of friction engendered by this. If we can see whether 2,000,000 represents the starting point, or whether it is two-thirds of 2,000,000, one-half or one-third, we get some sense of the scale.

Secondly, can I move on to your next point? How far is it possible to assess

whether that is in itself a transitional problem, in the sense that whenever we move from one system of tax to another, I assume that one has a lot of correspondence going on until people become familiar with it, as occurred with VAT. If people begin to understand that the 5p or the 3p, or whatever it may be, is a local authority matter and they can get a rebate if they tell you in time; if a general propaganda exercise is launched - this is bound to lie some years ahead - and if that is done effectively, will people not over a relatively short period of time cease to badger you and the local authorities about matters which after a relatively short period of time have become familiar to them?

-A: We had over two years enormous propaganda on post-war credits, telling people to claim, and we have still got 3,000,000 unpaid claims.

Q: Unpaid claims or unclaimed payments?

-A: We have records which show that 3,000,000 people have not claimed their post-war credits. One does all this, but it does not work. Somehow, people do not read, or, if they read, they do not take it in and understand it.

Q: But is that not answering your point to some extent? Let us say that the 2,000,000 is halved by all these other factors. Your worry is that if I move from a high rate authority to a low rate authority, I am going to write to you and say: "Why am I not getting by 2p back?"

-A: Yes.

Q: The point I am putting to you is that, surely, after a while are not people going to understand? First of all, if they do not read the propaganda and they move from a 3p authority to a 5p authority, they will not do anything about it and, presumably, that will be where the matter ends until you notice it and do something about it later.

-A: Well, we are a very conscientious lot.

Q: I accept that, but that is not a

question of causing friction. I am trying to explore it. I fully understand the point about the amount of friction you deal with in public administration, and, naturally, you are concerned about how much more this sort of thing would involve. I am trying to see what its dimensions are, because if people are not understanding the system, that may mean one of two things: it may mean that they pay it because they do not want to waste time writing letters, or it may cause them to write to you and say: "I want something back."

Q: Let us say that the local authority tax were an addition on the income tax, will the increase in the tax rate or the problem of people who change residence give rise to most of the work in relation to the kind of work that gives rise to friction, or are these two things strongly related?

-A: No, I do not think they are related. People tend to look at tax deductions as a sort of visitation from God. I think it is surprising how few complaints we got when people suffered at the end of May some quite large deductions of tax. I am sure they did not work it out, and most of them did not remember what the Chancellor had done. We got some complaints, but not a lot. I do not think people, except to grumble in pubs, do raise these questions. It might prompt them to do other things, like going to their Trade Union and saying: "This is my take-home pay this week, and I want some more wages." It might have effects like that, but between them and us, I do not think it raises many questions. If we go back to the particular question, again, I think it is the chaps who move and change residence and do not understand their position, who raise questions rather than people complaining that there is a bigger bite in their wages each week.

Q: I am very worried about this residence point, because while I fully understand that you feel very concerned about it and it is right that we should appreciate that, what I do not quite understand is that when one comes

to try to give it some weight and ascertain the order of magnitude of it, if we do not really know how many people are moving within a local authority, if we have no assessment at all of how many people are moving to areas which are low rated as against areas which are high rated, if we do not know how many of them would be people who would be assessed under Schedule D, and no doubt there are other factors which I am not aware of—if we have not a yardstick in those senses, how can we form any impression of how much anxiety ought to be attached to the very natural concern you have that this will stir up an awful lot of correspondence and friction?

—A: I think it is wrong to try to eliminate, for example, the man moving in the same local authority area. The average person cannot be expected to know precisely what the boundaries are of his particular authority, and he could, if he was aware of these things at all, wonder when he moved whether he was in the same authority or not. If he was, say, a civil servant—and teachers, civil servants and clergymen give us more correspondence than anyone else—he would write to Cardiff, where his tax is assessed and say: "I have now moved from Reading, where I travelled up to London, to Bracknell. Is this in the same authority area?" Cardiff probably will not know either, and they are very likely to write back to Reading or Bracknell and say: "Where is this street in this particular village," and then they would write to the person concerned, saying: "You are all right; you are in the same local authority area"; but you have generated for no purpose whatsoever a chain of correspondence.

Q: I think that is a shade less convincing than some of the other comments you have made, because the people you are referring to are people who were described some time ago by one of your colleagues as chronically articulate, and if it is a fact that when you introduce a new system there is a note on all documents you send out saying: "If you have changed your

address, please let us know," is it not evident that he is the sort of man who, by definition, will look at this document and say: "This asks if I am changing from one local authority to another," and he will write to the local authority or just write on the form that his address has been changed from so and so to so and so. I understand that this is bound to cause extra correspondence, but, as I understand it, it is the friction that you are justifiably worried about, about the chap who says: "You are levying more on me than my place of residence justifies."

—A: That is not the point. I am sorry if you do not find my example convincing, and let me try again. I try to answer every letter that is addressed to the Board or the Chairman, and I sign a lot of letters every day. You just have to trust my feeling that we will get lots of correspondence on this, because I know what correspondence on what subjects we do get.

—A: The thing that worries me is the same point put in a slightly different way. At the moment, we are not bothered where somebody lives. He may put where he lives on his return; he may come home at weekends and live somewhere else in the week; he may put his office address on or he may leave it to come through his employer. We just do not care as long as we can get in touch with him. Now, if we went over to this system, residence would be a thing which we had to care about, which we had to find out about. For example, some people have two houses, one near their place of work where they live during the week and the other somewhere else where they live at weekends, and we would be obliged to establish it with the chap who never bothered to tell us, and, I suppose, we might be thought to be under some obligation to make sure that we got it right, and this is a big new job. In the normal case, a chap just puts his address on, and that is all right, but a not very large percentage of cases where it is not as straightforward as that would create an awful lot of extra work. Some people say that the Revenue is obsessed with avoidance,

and perhaps we are a bit sometimes. With vehicle excise duty, it is sometimes said that the thing to do is to make this a local authority tax. The objection to that, or one of them, is that people would go and register their vehicles in particular areas so that they paid less. Now, do we have to see that that sort of thing does not happen with this system? If we do, how do we do it? I am not quite sure where we stop.

Q: There are two quite separate trains of thought here, and I am trying to see whether we can assess the importance which each has. There is the train of thought which says that there is a certain relationship between the Revenue and the public which is important to the success of the operation: the general public confidence, morale, lack of friction, and so on. That seems to be a very potent point, even though it is difficult to assess, and that seems to be quite separate from the question of how many extra people and how much extra cost. I am not saying that is not important, but what I was going to ask you about the second limb is that, presumably, that is taken into account in the assessment you have made about cost, and so on?

A: Yes.

Q: The friction point does not appear in that assessment. You have already put in your equation an allowance for cost, but friction is a different matter.

A: I am sorry; I thought you were suggesting that really it was not much trouble for us to do this.

Q: No, I am not suggesting that at all, but, in the end, the exercise we have got to do, as well as the one you have got to do, is going to be looked at by members of the Government and others in the House and very carefully weighed, and we have taken the view so far that one of the things we can probably contribute is to do some intelligent weighing of these things. Therefore, in things like residence, it seems to us important to be sure that we have got a correct measure from you that this is the amount of difficulty and this is the

amount of cost, and others will have to decide whether it is worth it or not. What troubles me about residence is that I see the administrative problem written into your assessment, but I find it very difficult to decide how serious this imponderable element of difficulty is, because what we were exploring was not the total overall cost, but whether the residence factor had special difficulties of its own.

Q: May I refer to the address point again? I think we have taken the point that the majority of people who are assessed under Schedule E have to make a return every three years, but are there not a great number of other dealings which the Inland Revenue have with individual taxpayers which would throw up a change of address; for example, with the receipt of coding changes, and also changes in allowances. I am thinking particularly of owner-occupiers who move, and very often that involves a new mortgage and a change in their interest allowance against the mortgage, and I would have thought that that, in itself, would have required the Inland Revenue to know the new address.

A: Yes, those things would, but it is still true that for the great majority of people, the settled married couple and the single person, we get returns at the beginning of year 1, say, and we send out a coding notice to them, which might be quite a simple one with either the single person's allowance or the married person's allowance. Then the thing works merrily without anything else at all for the three years, and then they get another return. This is quite a common case, and there is, in fact, no dealing within those three years and no assessment has to be made, because the coding is simple. A chap like this has only one source of income, the PAYE works as it is meant to with no assessment, and we never hear any more from him until we next send him a return, and we hope that we might find him at the old residence.

Q: Suppose he changes his job in the meantime?

-A: That is purely automatic.

Q: Do you then get a notification? Suppose he changes his job and his address; suppose he moves from London working for one firm and goes to Manchester working for another firm: do you hear about his new job through his employer?

-A: Yes.

Q: Do you hear about his new address?

-A: Yes, we do. It should be on his P.45.

Q: Is this not rather significant? Does this mean that the two million that we have been talking about does not include people who move to new jobs, because, if this is so, it seems to me that the long distance move becomes even less of a problem than I thought it was?

-A: Of course, we would know if there was a London to Manchester transfer and this would put us on to an enquiry, but of the 11,000,000 changes of jobs a year, that sort of move is, of course, a very small proportion. It is usually going from one building site to another, and that sort of thing.

Q: I was not thinking of that; I was thinking of the other way round. Earlier we have been talking about 2,000,000 people, who move their addresses between the three years and you do not know about it until the end of the three years, but are we not now eliminating those who move their addresses and their jobs at the same time?

-A: Let us be clear about this. The 2,000,000 is a Department of the Environment figure for the number of residence moves per year. So in three years it would be 6,000,000.

Q: Yes, I do see that.

-A: It is not our figure.

Q: But in that year as many of those 2,000,000 who change jobs will fall out of the non-notified residential change category, because the P.45 will have told you about those?

-A: Hopefully, as they say. There is provision for the employer to put the address on, but there are employers and employers. Certainly, if a man moved to a Manchester address, we would have to transfer the file and a whole host of things would put us on warning, but in the case of a man transferring from one London job to another London job, for example, or from one Manchester job to another Manchester job, probably we would not get the address from the employer and we would be no wiser.

Q: That would often show up across local authority boundary changes, would it not?

-A: Well, the man might not have moved his residence at all.

Q: You could tell that from the address, could you not?

-A: When the employer has filled it up, yes.

Q: Do we know what percentage of them do?

-A: No, we do not.

Q: We have looked at one or two foreign systems where residence is important, and where people might notify the local vicar or the local Town Hall where they live. Where you have 2,600 Parishes as in Sweden, there must be an enormous number of moves at Parish level, but it does not appear to create this sort of problem. When we say: "Is it a problem?" they say: "No." What is the difference about their systems?

-A: I do not know.

-A: In Sweden, the thing starts from local level, the administration is at local level, and somebody is on the ground keeping an eye on these things.

Q: Is there any material which suggests that the level of mobility is higher in any of the countries where local income tax is levied than it is in the UK?

-A: We have done what research is possible, but we do not know.

Q: Presumably, you envisage no problem with regard to the residence of Schedule D people?

-*A:* No. One has to determine their address, of course.

Q: Yes, but ignoring that, the people who have forms sent to them every three years are the people you are concerned about?

-*A:* Yes.

Q: Would you really need to know where they lived as long as their employers knew where they lived?

-*A:* We had not envisaged in any schemes we have devised that the employer would say to the chap: "Well, where do you live? Which local authority do you come under?" and do a sort of employer assessment. We have always imagined that we would give the employer the information. As I say, some employers would do this and be very good, but there are a million employers, and some are not reliable in tax terms. We have people going round asking them for money and having to fill up their forms at the end of the year. These are among the small employers.

Q: So the employer would not just look and say: "Ah, this person lives in Surrey"?

-*A:* We just could not trust them to do it. As I say, a lot of big employers, yes, but the smaller people, who are the majority, we would have to do something about.

-*A:* I think this would be particularly so if, as in the scheme you sent to us, residence depended on the residence on a particular day in the previous year.

Q: The employer could ask the employee: "Where did you live on the 1st September?" and then look it up in the list, could he not?

-*A:* Yes.

-*A:* One can postulate, but I must take you out and meet some employers.

Q: Could I pursue the point about owner-occupiers for a moment, because I imagine there must be quite a number

of cases where people who are owner-occupiers take a new mortgage when they move and would, therefore, have some change in their tax allowance. Would that be known to the Inland Revenue?

-*A:* Yes, we get that information from the building societies.

Q: I was wondering if you could give us an estimate of how many cases that amounts to per annum to see whether that is a significant portion of the 2,000,000?

-*A:* It is not on the top of my head, but we certainly could.

-*A:* The number who do not get a return every year is 12,000,000, and we have to send a return to about 25 per cent of that number at some time during the three-year period for some reason or other. So that still leaves 9,000,000 who do really wait for three years.

Q: Is there any estimate of what proportion of that 9,000,000 do not move in the three years? It seems to me that if you change your job or you change your circumstances, you would be reassessed and that sort of person would be included in the 25 per cent, but it is quite probable that the proportion of people which are left, who move with no notifiable change of circumstances, must be quite low.

-*A:* Yes.

Q: Just one question before we leave residence. If one were to ask you what you think would be the best way of establishing residence for a local surcharge on the rates which took the form of some kind of levy, whether a standard one or a graduated one, on wage earning non-ratepayers, what would your answer be? How would you think it would be best done to establish residence for that purpose.

-*A:* You are thinking here of what category?

Q: Non-ratepayer wage earners.

-*A:* The single son living at home with his parents?

Q: Yes, that sort of chap.

-A: That is not something that we have got readily available. If one takes a household of a grown up son and daughter, father and mother, if the father is a Civil Servant, he would be assessed in Cardiff; the mother might go to work locally, perhaps in a hospital or shop, and be dealt with if in London, in Manchester; the son might be a partner in a firm of accountants and dealt with in London, and the daughter might have another job dealt with in Middlesbrough. So in the Department as a whole there will be all those four people and that common address, but there is no way in which we could bring them together and say that four people lived in that house and that they were all earning.

Q: So, for this purpose, as indeed for local income tax, you would really have to ask somebody, whether the taxpayer or the householder, to make a declaration?

-A: Yes, which he does every year, of course, for the electoral register.

Q: Yes, the electoral register just crossed my mind. So, if the Revenue were asked to produce this information, even if it was just simply saying: "Give us the names of all the taxpayers in Manchester," which the local authority would then have to check against their ratepayers' list and arrive at a residual, you would have to do that for local income tax, or something rather similar, that is to say, you would have to ask people in the first instance?

-A: Yes. I think one wants to emphasise the degree to which people are not taxed in the district where they live. This is not only an exercise that has been forced on us because of the shortage of staff in London and having to move work out to the provinces but because people working for employers are dealt with at the head office of that employment possibly miles away. Just before I got in the car to come down here I signed a letter to Mr Robert Maclelland, the Member for Caithness, who was writing to me because one of

his constituents in Caithness had complained that her tax was more than she thought it ought to be. In our reply we said we had to go to Chippenham to get information about her employment. That might have been exceptional and it surprised me, but it just shows what can happen.

Q: So, under any kind of local tax which is dependent on residence, there is no alternative, other than possibly a national register for some kind of tax, to actually asking the taxpayer to tell you where he lives?

-A: We shall be getting computers, but we have not got them yet. Until then we cannot see any other alternative.

Q: The next item on my original list was self-assessment. I wonder if, perhaps, the quickest way into the question would be to ask you whether you think that, whatever its problems – and you have been outlining some of them – a system such as on this piece of paper you have would be better than a total system of self-assessment.

-A: We have not considered what self-assessment might mean. I confess that what put it in our minds was the fact that a lot of people each year, in applying for university grants for their children, do a form of self-assessment by stating their total income and claiming certain rather primitive allowances, and thus getting at a figure on which the student's grant is assessed. It did occur to us that something along these lines might be possible.

Q: There must be quite a lot of other fields in which that kind of thing obtains – mortgages, loans, and so on – where people have to do this.

-A: Yes.

Q: Is there any point in self-assessment, if you like, if the Inland Revenue is the collector? Assuming the existing system of national income tax, if the Inland Revenue were to collect the local income tax, would there be any point in having self-assessment?

-A: No.

Q: The self-assessment is essentially based on the assumption that the local authority are doing the administration themselves from beginning to end?

-A: Yes.

Q: Is it possible to put any figures of the cost of the amount of staff required with self-assessment?

-A: We have not done so. We could have a go at giving you some figures.

Q: I think it would be helpful, because clearly it is going to be asked whether there is another way, not only because it has attractions of its own, but because it would take it out of the complications element of your own national network if it could be done that way.

-A: There is the point that the local authority have got to ask some people for student grant returns, but can we look at this generally?

Q: Yes, certainly. Clearly, it provides an alternative. We would hope that the debate at this stage could come to a firm conclusion one way or the other, and clearly this is a question that is going to be asked.

-A: Could I just say that I think one would only visualise or we would only be suggesting a form of self-assessment on the basis that what one wanted was a supplement to the rates, because with a fairly low take one can take the risks that a self-assessment scheme envisages. I think if you were replacing rates with a necessarily higher take one would hesitate.

-A: One assumes, too, that it would be a simpler sort of tax than our national tax.

Q: Can we postulate one? You have your methods for assessing staff requirements, and let us concede that one of the characteristics of our self-assessment system might be that it is relatively small in terms of its take. If we were to give you the prescription and to write to you and say: "We expect it to be collected by 40 local authorities", would your methods give you a basis for giving us a necessarily very broad assessment

of quite what it might mean in terms of staff?

-A: We have figures which give staff consequences of certain processes. This is how we could do it. We imagine the processes and then put staffing figures to them. We would be quite happy to do this without any guarantee about its reliability.

Q: Could we also have some assistance on the question of how small is small. I fully understand your point that there comes a point somewhere in the scale where you balance the risks of self-assessment, on the one hand, with the amount one is seeking to gain, on the other hand, and get out a relationship one with the other. So there are really two questions that follow from that. First of all, what is the criteria that decides the relationship one to the other, and could there be any guidance on where that ceiling might be, because this again affects it?

-A: I think one of the problems here is what sort of penalties one seeks to impose for wrong self-assessment. After all, the American tax system runs itself on the basis of self-assessment, but with very, very stiff penalties indeed should the American revenue discover that an assessment is wrong. I was thinking in terms of something like the same rather inadequate powers that the Inland Revenue have for seeking out and penalising wrong information, and I would have thought that with those one could not be at risk for more than payments in the low hundreds, as it were. Once a potential payment starts getting into thousands of pounds or more, I think one ought to get very worried about self-assessment without very stiff penalties indeed.

Q: Does it follow, in terms of the scale which you are talking about, that that would be potentially capable of producing something equivalent to the present yield from domestic rates?

-A: I would have thought that would be about the limit, yes.

Q: It would be helpful as a yardstick to know that.

-A: I was thinking about a 5p charge, which is about the domestic rate.

Q: We have been discussing at some length in the context of determining residence the question of friction, the thing which is there in cost in a way, but is also something additional to cost. I suppose, self-assessment passes the friction down to local level?

-A: Yes.

Q: I am just making an observation. I do not know what we conclude from this. I think you are implying that there would be quite a lot of friction in self-assessment?

-A: I am not sure. Again, I think it depends, first of all, on what checks local authorities thought it right to ask for. One way of doing self-assessment is not to have any checks at all, just to accept what you are sent. I was not thinking of anything quite like that, but the local authorities could, as a beginning, ask the self-employed man, who declared his profits, if he would send along his income tax assessment to check that, or an employed his P.60 to check that, or a sample check of dividend vouchers - this sort of thing. It is entirely at your discretion how much of this you want. The other point is, I think, if you find it is wrong, that the man has not declared some dividends that he ought to have declared, what then do you do? Do you charge him very stiffly? If so, you will get more compliance but more friction than if you do not.

Q: Would there be any merit, from the point of view of a sanction, of saying that the whole system is for the local authorities to run and operate, with the one exception that if they wished to place a check on random assessments here and there, that is a matter which they would pass over to you, because you have specialist machinery for doing that, your confidentiality standing is very high and, therefore, there is less objection to it and your method is more sophisticated? Would that be an acceptable relationship?

-A: I am not quite sure how the confidentiality would stand up if, they having passed it over for check, we said it was wrong, unless we then took over.

Q: Presumably, you would.
-A: Yes.

Q: You would say: "Here are certain assessments. Will you have a random check, and if you are not satisfied we will take action"?

-A: Yes. I am not quite sure how far down the road this goes. If we discover when we take action that a man has misdeclared, and we say: "You owe another £200 local tax," do we then tell the local authority, because the confidentiality has gone at the point where we tell the local authority that this man has underpaid £200?

Q: There are two possibilities there. One is that you simply act as a sort of DPP, and you say: "This is found proved so far as we are concerned, here is the indictment," and it is for the local authority to process it. The other possibility is to say: "No, once it is passed to us, it is wholly with us and we shall take the action we think is necessary by national standards, and the principles we shall try to adopt in respect of this evasion or misdeclaration will be the same throughout the country, and any sums recovered will be sent to you."

-A: Yes, that would be possible, as long as we did not get too many.

Q: Presumably you would discuss with the local authorities what sort of spot checks could be done?

-A: Yes. We have not really got time to do all our own.

Q: This sort of system is worked in the United States.

-A: Yes.

Q: One of the reasons I raised this is that it seems to me, though added work, that this would be an advantage from your point of view, because it is another check.

-A: Yes.

Q: The thing that worries me is how you know the chap who is self-assessed in the first place. You have got the electoral register, which is notoriously inaccurate, and the temptation would be for anybody to omit filling in the form each year. You are not in a position to tell the local authority who are wage earners in any particular house, and I do not see how you catch them.

-A: I would not suggest that you go back to the way the income tax system invited people to show themselves, which was by a church door notice, and that disappeared in 1942. But there is still a legal obligation on a taxpayer to declare income, and penalties attend his not doing so. I would have thought that a self-assessed tax by a local authority would certainly have to start with that, and then I would imagine that there would be some system of returns. We have not actually thought this out, but local employers might give us returns, or something of that kind, plus the electoral register. I agree that it would be difficult, but certainly, the obligation must, I think, be there in the first place with a penalty.

Q: Presumably, you would fill up your material as you went along?

-A: Yes, once you got started.

Q: Can we turn now to the question of costs. In Paragraph 48 of your Memorandum you give us some estimates, but you said a short time ago that you had certain methods for assessing the costs of particular procedures. It might be helpful to us if you could describe how you built up the 22,500 estimate for locally variable rates. I do not mean every aspect of it, but the main component items of the 22,500 staff estimate on the locally variable rates.

-A: I very much regret that I have not got the details of this with me, but we can certainly send it. I know how it would have been done, and if it would be useful to expand on this with a paper, we would be glad to send it to you.

What we do is to analyse in terms of our millions of PAYE assessments and Schedule D assessments what one assessment would take in terms of staff. That we break down into a number of processes, such as sending out the return, getting the return back, examining it, and that sort of thing, and that gives a unit cost per assessment, and so on through the whole variety of operations that we carry out in the Revenue. The way we arrived at the figures in this paper was to have a model of the sort of scheme as we envisaged it - it was not Mr McIntosh's scheme, as we have referred to it, but something of the kind of scheme that we have envisaged in the earlier discussions - and applied those factors to the operations that we saw emerging. For example, a PAYE case has a much higher staff cost factor, obviously, if we have to make an assessment at the end of the year one which we can just pass merely by seeing the tax deduction card and not doing anything more to it. We have envisaged that we would have to have an annual assessment for all PAYE cases in the figures here, and the results have been built up by applying that factor to so many assessments. We can let you have a detailed breakdown, but that is the methodology, as they say.

Q: Is there an implication there that something like this cockshy would somewhat reduce the staff element?

-A: Yes, I do not think there is any doubt about that. I am not sure by how much, but in the sense that our scheme had two sides to the operation, first, the collection and secondly the accurate passing over pound by pound, insofar as there is some costing involved in the second bit, which would not be necessary under the cockshy yes, it would be reduced.

Q: Can you remind the Committee what the relationship is between the 22,500 and the existing staff of the Revenue?

-A: Yes. We have got a staff altogether of something like 77,000, but part of that, of course, is engaged on operations

other than income tax. Something like 10,000 are in the Valuation Office, which you are interested in from another point of view, and there are odds and ends like superannuation, the Tithe Office, and so on. The actual number of people that I suggest would come into the picture for this purpose, the immediately comparable people, would be: in in our present Chief Inspectorate Branch something between 47,000 and 48,000, plus the people in our Collection Offices which would be another 10,000 to 12,000. So about 60,000.

Q: As you have not got the breakdown with you, can we consider whether we would like to ask you about that in writing?

-A: Yes.

Q: Thank you very much. Can we come to the overall cost figure sticking to the central estimate about the locally variable tax, which is acknowledgely somewhat less for the Revenue. There are two other aspects, one is the local authority cost, where you give us an estimate and I do not think I would want to pursue that particular one at this stage. What I am really concerned about is the estimate of the cost elsewhere in the economy, where you suggest that some previous research or inquiry implies just under a one-for-one relationship in the employer's staff cost and public service cost.

-A: Is this Sandford?

Q: This is Sandford. Now, is this a marginal cost concept on changes in the tax system, or is it an average?

-A: Very largely just the operation in employers' offices of working the PAYE system.

Q: So it is an estimate of the relative costs as they stood at a given moment?

-A: Yes.

Q: So it is an average cost rather than a marginal cost?

-A: Yes.

Q: Is there a presumption that the

marginal cost would be the same as the average cost or not?

-A: No, it would not be, would it? If one has to do a payroll anyway and adds a deduction of PAYE to this operation, it becomes a marginal cost.

Q: Can we pursue how you translate staff costs into figures? You have got the £30,000,000 to £45,000,000 for the revenue. Now, that is a staff cost. Is that going to cover wages and related costs of accommodation, etc; is it a total cost?

-A: I imagine it would be, yes, at 1974 salaries, of course. It would be more now.

Q: It seems low somehow. It is 22,500 into 45,000,000, which is 2,000, is it not?

-A: Yes.

Q: It sounds awfully low if it is the total cost per head, including accommodation and all the other things.

-A: I agree when you put it like that, and I think we had better check it.

Q: Yes. Teachers cost much more than that per head, and even assuming that these people are paid on average significantly less than teachers, it would be very surprising to have such a total.

-A: I do not think that is quite true. What may have happened here is that for the strictly arithmetical job of adding 5p to the existing charge, some fairly low grade staff are reckoned to be employed.

Q: I think we really need to get to a full cost charge here, although we have to do it by a rough method. We have to add the private sector cost, and, in a sense, switching between the public sector and the private sector in the costs ought to be relevant, because costs are costs wherever they are borne, and this is bound to build up to a very big figure. Using your kind of arithmetic, one arrives at £100,000,000.

-A: I think we ought to let you have an extension of Paragraph 48.

Q: I think we are really asking for a

number of things here. The first is for a breakdown of the staff figures. The second is a cockshy at how far we can bring the 22,000 down in relation to something like that scheme. The third is the local authority self-administered scheme; I think it would be interesting to see what your methods produced as a figure on that. The fourth is that we would like to feel assured of how you translate 22,000, or any other figure, into a money cost, because I must say that it looks frightfully low to me.

-A: I agree that £2,000 average looks too small.

Q: Yes, even at 1974 prices.

Q: There are really two groups of things that we would like some more information on. First of all, the self-assessment approach, an idea of how that might be done, including possible ways of dealing with checking. If there are other ways than the ways we have canvassed today, that might well be worth a report. I would also find it helpful to know how far you think it is in your interests to keep the spot checking and enforcement under your control. Then there comes the cost side, the three bases that you have been mentioning, namely, any revision as well as an explanation of how the figures were reached. Secondly, what I call our kite, and, thirdly, on self-assessment, can you give us any indication as to how that would work out. I very much agree with the point my colleague is making, that if there are costs other than public costs, these should also be included.

-A: We cannot get nearer than doing a sort of Sandford exercise.

Q: No.

Q: On the self-assessment point, we have had it put to us that in countries that run self-assessment schemes there are fantastic personal costs to individuals which are allowable as part of the total cost.

-A: These are notional costs to some extent.

Q: I just want to say that there were one or two other topics, which are really outside the main stream of the discussion we have had today, which were referred to in a letter which Mr McIntosh wrote to Mr Thomas, which concern questions of domestic relief and possible implications of the tax system in various ploys. I only mention this, because I think we want to consider how best they are pursued. The two ways seem to be either that the Revenue should respond in writing perhaps, or that we should organise a smaller group for a rather less formal discussion, or perhaps start with the one and proceed to the other, if that seems to be necessary.

Q: I think, in terms of economy of your time as well as ours, it might be best, dependent on the time scale, if we could have the papers from you that you have promised and then continue the discussion on one basis or another, because there are quite a number of points which we have not yet reached and which we shall probably be better able to understand when we have thought over what you have told us today.

Q: I think these are pretty well self-contained points and do not contain the complications of the things that we have been discussing, and perhaps a paper would be the best way of dealing with them.

Q: Can I just add that we would like at some time to have your aid on the Schedule A point.

-A: I would be very happy to send you a paper which you could consider. Is it just our general experience in running Schedule A that you are interested in?

Q: It really comes up in this way, that, obviously, rates are a tax variously defined, but a tax on the occupation of property. Schedule A was a tax on the ownership of property, and there are variants of property taxes. There are some people who would suggest that we should look at the whole fiscal complex

of property together, including subsidies, and so on, and I think we all feel – because there is not really a tax expert amongst us in any genuine sense – that Schedule A is something we used to pay and we cannot quite remember why it was given up. We can see the economic case for Schedule A, but we do not know much about the administrative problems that underly it or the experience of the Revenue in administering it. Is that a fair description?

Q: Yes. What lessons are to be learned from your experience of Schedule A. Thank you very much, indeed, gentlemen. We are most grateful, and I am sure that we understand a great deal more about this complicated business that we did when we started, and I hope we will be able to renew this on some mutually convenient date.

-A: Yes; we will be very happy to come back, and thank you for the kind way you have listened to us.

Oral Evidence by the Inland Revenue

SECOND SESSION - 16 JULY 1975

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ORAL EVIDENCE—INLAND REVENUE

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(From the Shorthand Notes of Walsh & Sons, 55-57 Clifford's Inn, Fetter Lane,
London EC4A 1BU)

Q: Sir Norman, before we turn to the business of this morning, may I take this opportunity to thank you directly for the suggestion you have been kind enough to make that we might visit the offices in the North West which, as you know, we did, readily adopting your suggestion, and we found it all very valuable and very enjoyable and, as I am sure you intended, it taught us a lot about some of the mechanical and administrative difficulties which, though rehearsed in words, always look more interesting and effective when seen in the round. I think it gave to those of us who were able to go a much clearer understanding of the residence problems that you are likely to turn to. We have I think fully appreciated what you are saying as to the nature and extent of the problems, and your officers were most helpful to show us what we wanted to see.

A: I am glad it was a happy occasion as well as an instructive one.

Q: It certainly was. As you know, we would like if time permits to take up your suggestion of going to East Kilbride.

A: Yes. That is much more the sort of future we envisage. It won't be quite

like that, but at least it will be computer-based.

Q: You remember we agreed — I hope we agreed; it was certainly our view — that it was a very important part of the Committee's exercise to try and help those members of the public who are going to make a decision on this as well as Ministers and others in a position to take a final and decisive view one way or the other, either about local income tax or some form of it or related matters such as surcharge and so on, so that if today when we return to residence and other matters we do not look as though we fully understood what we saw in the office, I hope you will not think that is right but we do want to be absolutely sure that we have fully understood the whole problem.

Thank you also for the further papers you were good enough to let us have, and it is mainly with those that we would like to pursue the matter today, to make sure our understanding of what is being said is as clear as it can be.

With that general preamble, unless there is anything you wanted to add before we started....

A: I do not think so. There are one or two points within the papers, glosses

and so on, which will emerge during our discussion.

Q: Good. Now I am going to ask my colleague to return to the frequent topic of residence. I will ask him to start with a question we would like to raise as a result of reading the papers you have given us.

Q: The main points to cover here seem to be the problems of statutorily defining residence and means of communicating to the employer and to yourselves. I think it is clear from your paper – and I wonder if you would say whether you agree this is a reasonable summary – that confidentially held addresses are really not good enough as a formal basis for a LIT taxation.

-A: This is very much how we would feel, yes.

Q: This suggests that a statutory definition of places of abode and formal means of obtaining them from individuals, and changes to them would be a requirement of LIT, but there has been a long history in this country of not having such a requirement placed on individuals.

-A: Yes, this is right. If one can make a comparison, there is a great deal of law – spelt both l-a-w and l-o-r-e – about residence in the United Kingdom as distinct from residence in an overseas country, for the purpose of levying tax, and while it may not be necessary to go into quite the same sort of detail, one would have to have an approach of that kind in order to ascertain where the money was going to which particular local authority, and also to grant the power to make a levy on particular person. Therefore I think you would have to have fairly precise rules.

Q: Going back for some time now, there has been at Civil Servant level and officer level in different public bodies a number of attempts to obtain a common data processing format for basic information. I wonder if you could

give us your view about the present state of this obviously bureaucratic but desirable proposition.

-A: Yes. Although I have not been privy to all the detailed discussions, I gather that some 10 or 15 years ago there was a very ambitious attempt launched by the man who is now the Director and Registrar General of the Office of Populations and Census – that is not quite right, but you know the man I mean. I think throughout Whitehall he began the idea of having a common identity number, for use in all Departments. This progressed rather spasmodically for some time, and at present there is not a working proposal of this kind; I think people are a bit frightened about the idea of 1984 and the sort of thing. But we have of course made some approach with this ourselves by adopting in Scotland – where we have a computer doing income tax – the national insurance number as our reference number, and it was our intention as we spread ADP into other parts of the country, which we still hope to do, to adopt the national insurance number of individuals as our reference. It has its drawbacks; it is very difficult indeed to persuade a taxpayer in Wick that when he is writing to East Kilbride we will not be able to find his records unless he quotes his national insurance number, but I think after a period of six or seven years – this lesson is generally being learnt but it takes a long time. But I think the national insurance number is probably the key to the wider use of a common number throughout government.

Q: I am not so concerned about the common number, but the other important feature which would go with this proposition which is the recording of individuals and their place of work and their place of residence in a more formal way for the various purposes of government, and to some extent the bridging of certain functions, tax and insurance, can be done within the machine without coming to this point. I wonder whether, to your knowledge, there is any movement towards this.

-A: No, certainly not known to us.

Q: So it stays where it is as a data processing bureaucratic proposition?

-A: I think so. If I can just repeat, I do not think that any idea that I have ever heard about has gone to the point of the address. It is always to identify an individual rather than where he lives. Even of the propositions I have heard were implemented and all the difficulties were removed, I would still think it might be difficult to go to an address, a residence.

Q: I wonder if we could agree that for the majority of people there is really no difficulty in defining their residence, and that the main problem arises from the hard core of mobile people, the Forces and so on?

-A: Yes, not just mobile people of course but the growing number of people with two houses.

Q: Defining which is which?

-A: Well, this I would have thought was a question for you. It worried me. If a person has a house in Kensington and a cottage in North Wales at present he is paying rates, presumably, to both authorities. If one had a form of local income tax, particularly if based on income, what would be the proposition - that he should pay on his total income in both places? I do not know the answer to that problem but I think it is one you have got to think about as well as about the mobiles.

Q: Given an acceptable definition of 'residence', which we have not yet got, but given that, what in your experience would be the relative merits of an annual return from individuals stating their address or separate notification of change of residence? Is it an 'either or' situation or would we need to have both for the purpose of LIT?

-A: I think we would probably approach this on a rather belt and braces line. I would have thought we would have said if one is to have only one of them, then the annual return is right because you cannot rely on people to

notify something more or less voluntarily. This is the less safe way of finding out. Scores of thousands of people will not make an annual return, but one can face that and at least one has got a solid base. So I would have said, if you only have one, then it is the annual return, but possibly the thing to do is to have an annual return and also have an obligation to notify change of address.

Q: Coming back to our difficult hard core of groups, what would be the objections to charging a special rate for these groups, assuming that they are a relatively small minority of the whole, and that in any tax system there are always exceptions? Without going to the problem of trying to force an assumption that they live in a particular area, what would be the objection to taxing them on a special rate?

-A: Well it would depend what that rate was. You see, although we are only too well aware that people escape the net, the net is at least defined as common for everybody. A group of people perhaps dodge the tax, but nevertheless the law is there which says they ought to pay. It is a different proposition if one is going to say certain rates apply to nearly everybody but there is a certain group of people to whom somewhat less tax applies. This is I think not at one with the income tax approach. One is in effect saying that a certain group of people shall opt out of our system. We do not say that for income tax although we know that some people do. I would have thought that that is an initial difficulty, because if you gave this group advantageous terms everybody would want to join the club.

Q: Would there be a significant difference in a LIT situation in that throughout the country there would be different rates of tax, and therefore a special rate being an average would appear to be equitable whereas in comparison with the income tax there is a single equity standard to compare it to? Would there not be a case for saying a special rate - maybe the word

'special' is not correct; an equivalent rate - might be a way of handling some of the difficult groups?

-A: Yes, but have you not got a difficulty? You really have to say in the law something to the effect that someone who has been living in a house and has lived for X years will be dealt with in one way. How do you define your exceptions? This is rather awkward. Somebody who has not lived in a house for three years, four years?

Q: This is where we come back to this first question about statutorily defining. If we leave it as now then we are in a problem.

-A: Yes, I know, but the statutory definitions give you a place for each individual, do they not? They do not leave a group out. They say either you are here or you are there, but they do not say that you are in the middle. They set out a sort of 'yes/no' situation rather than a 'yes/no/maybe', as this proposal would seem to indicate.

Q: Well, not necessarily, if we assume in fact that certain groups who are not in the statutory definition are in the 'no' situation.

-A: Yes, it would have to be done on a time basis; if you have not been in for X years then you are in this other group. Yes, that sort of thing would be possible I think.

-A: Could I make a point on that. If you have a median rate here it must presumably be higher than the rates in some areas and lower than the rates in other areas. So in one area it would pay a chap to say "Yes, I belong to this group" and in another it would not. I do not know how closely you would expect us to look at people who say "We are mobile and have this special rate", but clearly there is scope for playing the system here.

Q: I think if I could just return to that, I think at any rate as I would envisage it at the moment, the rules would have to be definitive even though like every other tax situation one would appreciate that some people would get

round the rules, but I am sure we would want it to be clear. I think the only point at which there would be room for some latitude would be the sort of point that was raised last time; you would have to take an arbitrary date of residence and in that case some authorities would lose on the margin and some authorities would gain. Apart from that latitude, I think most of us would say this system was as clear and firm as any other taxation system so that there were not frailties - it would be curious to try and avoid the frailties of one system by building another on a similar foundation.

Q: It may be there are two classes of exception, those who statutorily you would define as being an exception - maybe the Forces, maybe seamen, this sort of category who could fall into a definition - and they would be charged at possibly some norm rate, and then perhaps there could be another class who for one reason or another had not registered themselves but you knew they existed. Maybe there is a case there for something like an emergency coding until such time as they declare themselves.

Q: I wonder if we are not making an error of principle here. If we have people who by definition are not resident anyway in a locality, ought they to be required to pay a local tax at all? This is a question of principle but it is worth pausing on, because if one answers my question in the negative that, no, one should not require them to pay the tax, would this have curious administrative implications? What you would have to do then is you would have to have a definition of people who are not so resident, and you would have this possibly giving rise to some pressure of one kind or another. How would you react to that?

-A: I think I must throw back to you the question what sort of income tax are you thinking about? If you are thinking of every national taxpayer also having to contribute to some local authority or another, then I would have

thought the sort of sketch that you were drawing is relevant but if one goes the other way and says you are only liable to LIT if you are a householder and you have been for so many years, then I think you have got a different ball game altogether. One has got to define, I agree, first of all who it is that you are after.

Q: Can I just pursue this for one second. Ideally I think we would start on any local tax that we prefer local tax to be paid by local residents who are also local electors and this is, as it were, the starting point, democratic accountability if you like. Now of course the ideal and what is practical do not necessarily fit. I think one wants to catch not just householders, it can be, but if one is going to have another tax whether in substitute for or in complement to the existing level of tax, I think one particularly wants to catch people who are residents but not householders. That much I think is axiomatic, otherwise why bother at all? Thereafter,

—A: would have thought that ideally would be residence in an area which would determine where you paid and indeed whether you paid, and that the soldier serving overseas ought not to be paying local income tax because he is not voting in local elections. But is this a different problem? Perhaps it is the same administrative problem whether one decides to leave these people out or charge them at some median rate. Perhaps the problem is the same, all-right, but whether the pressures would be the same on you. . . You are good judges of the likely pressures I think as well as of the administrative problems.

—A: Again I think it is a question of whom you want. I certainly go for householders as my "a" of the relevant section but "b" certainly would be wife perhaps or children who are working and live at home, "c" lodgers for X years. The sort of chap that I am worried about—and when I explain it you will realise why I am worried—is not the soldier serving overseas but the peripatetic sub-contractor, with whom we are very familiar. We have special

arrangements for the deduction of income tax,—the sort of chap who moves around in different local authority areas making roads. He would not I think meet the sort of definition you are after. Do you want him in the net or not?

Q: Of course if we adopt a principle that if somebody is not resident locally then they do not pay a tax, then your point comes in with a vengeance.

Q: Can you double bank here? I am thinking of your contractor. Can you start by saying that anybody who is resident in the ordinary normal sense at their normal place of abode will pay, and where you have a person who has premises which he occupies in the ordinary sense of the word but would not fall into the first definition, which would be deemed to be residence for those purposes—leaving your statutory exceptions which are statutorily defined as out—would that not catch up with everybody else?

—A: I think it may.

Q: Because so often statutes say if the facts are such then you shall qualify; and if under a second definition you qualify, you shall be deemed to be in the first class. I am thinking of your question, "Do you want to catch him?"; if your contractor would ordinarily have paid rates on his premises we do want to catch him. Now if he did not fall within the first definition but occupied, in any ordinary sense, premises, then he must be deemed to be resident in those premises.

—A: These chaps would not in the sense I think you mean have premises. They would be moving from lodging house to lodging house and staying at each just so long as it took to do up that bit of road. There is, perhaps, no particular reason on the philosophy we were talking about last time, why he should contribute to local services perhaps and, therefore, on that line he ought to be exempt. The difficulty here I think is that if one had an exempt area there would be a great rush to get into it.

Q: I am not sure that a double bank would not produce a satisfactory solution because really if he is not by any ordinary standards resident anyway then there is obviously a good argument for saying he is not a man liable to this local income tax. But if he is the sort of man, who I imagine is probably quite numerous, certainly among some of the contracting force, who is ordinarily resident in London but spends more than three-quarters of the year away, including the day when we say "Right, that's the day when we test the actual residence" then he would be caught and should be caught because he has a proper place of residence in the ordinary lay sense of the word. You would not get an awful lot of people, would you, missing out on a two-tier definition like that?

-A: Only the Irish people.

Q: They seem to get out anyway. Suppose you double banked your definition in that way, would there be any other category of an evident kind apart from the itinerant labourer in the contracting force? You see, one of my reasons for thinking of a double level is that we were being shown a number of other problems that can happen, a very high rate of turnover of cleaners and caterers, but from looking at such documents as we have had time to look at it at least seemed very likely and in some cases quite evident that the itinerant person had an abode. He flitted about in employment terms and lodgings terms but he still had a home. So the double definition would catch him. I can quite see that the wholly itinerant labourer is not caught, but is there anybody else that springs to mind?

-A: Yes. This might be a rather esoteric class but one could have a not inconsiderable group of people who, if one said "You must be resident for LIT purposes on such and such a day" would include the foreign visitor, who would not be liable for income tax perhaps because he is here less than six months, but if your day was within his term of being here (he might have a

furnished house or something of that kind) he might be a problem. We may not even know about him. He may not matter, however.

Q: What about retired people living in hotels?

-A: I would assume that would be caught by residence, if it was a residential hotel. If they are moving from hotel to hotel that might be awkward.

Q: That might be worth their while if they were rich.

Q: Could I go back for a moment to the small group, e.g. the itinerant labourer, who for one reason or another you cannot pin down, in the first definition, in the fallback definition. Would there be real problems associated with a relatively high but not too high emergency rate which caused them either to pay up or register themselves, because they were supposed to register?

-A: No, I think the mechanics of that would be easier than the justification, as it were, for charging at all. As you possibly know we have an arrangement introduced by the 1972 Finance Act for sub-contractors, the notorious card which procures them exemption from deduction of tax by the contractor. If they cannot produce a card—and our intention is to make it more difficult for cards to be issued—tax at the rate of 35 per cent is deducted by the contractor as a sort of payment on account of the eventual amount due. One could put that up to 40 per cent to catch local income tax and sort it out afterwards so the mechanics of it I think would be fairly easy.

Q: I am not on the justification, but I am suggesting they are due to register but until such time as they do they are paying on account.

-A: That is right, and our test for issuing a card, or one of the tests, is going to be that they have a place of business, and that will tie up with, if not residence, at least some sort of stationary place.

Q: A general point. We know of the difficulties of applying a LIT, given your present system of tax administration and also the pressures under which you operate. This is probably fully recorded. But if you take a long view, is there any reason for us to think that the administrative problems of a LIT in this country would be any different to that of any other country?

-A: I think they would be different, but when I say that I am not saying that it would be impossible in certain circumstances to have a LIT. If we moved to a much more comprehensive computer ADP scheme than we have got at present, I think one begins to see LIT as a rational step, but it will not be like that of any other country for the reason I gave when I was here before, that the general theory, the approach of tax in this country, is that you go not to an individual but to a source of income and try and tax there. Therefore one is not, with our general concept, looking immediately at an individual. In Continental countries they are saying to an individual "What is your total income?" and from that they can get to national tax and LIT. So long as we are always looking at sources, and have this concept of deduction of tax at source, there is a difficulty about it. We have got to use mechanical means to get all the information together before we can start applying a total income concept. I think this is it basically, but it is not impossible if we have the mechanical means.

-A: If I could make the same point in a slightly different way, I think I am right in saying that in foreign countries where they have a local income tax there has been a local element from the beginning. The two have, so to speak, developed side by side, and all new development have been brought in with an eye to the local element. Here we have a fully developed system and we would be, so to speak, grafting this element right on the top and it is rather that difficult.

-A: The German system illustrates this best I think because it is essentially based on the local concept. The national

body takes its information from the local, whereas we would be dispersing instead of bringing together.

Q: Could I just ask something. You do not believe that there is anything peculiar as it were about the social habits in the United Kingdom which make it more difficult? Simply the history of the tax?

-A: Yes.

Q: You mentioned Germany, and I think this is a non-administrative point in a way, but Germany is interesting because it does start with a local tax, and one of the points that has been made to us by the Treasury among others is that the split of income tax between central and local in some measure would reduce the flexibility and flow of the central government in the use of income tax as an economic regulator. Is it your impression that this in fact is the consequence in Germany? Because it starts that way, is it in fact the case that it is the central government that is the residual legatee as it were of the income tax? Is the fact that it is collected this way a restraint on central taxation?

-A: I do not think it is a constraint, in that sense, but there is also a sense in which it is the residual legatee; it comes last.

Q: It is not quite relevant to this point, but you do have contact with other tax authorities and in particular Germany?

-A: Yes.

Q: I wonder whether you get any feelings on this.

-A: I do not think where they have the local tax it has ever been alleged that there is a constraint.

Q: Could we turn to a related point which I only take next because it is linked to residence. In Section VII of the paper you sent us on 11th July, under Notification of Taxpayers to Local Authorities, you deal with the need for a residence inquiry, and you

give an estimate of the staff, 1,500, that you would need for that sort of inquiry. I am not quite sure whether that estimate from what you say, particularly in paragraph 7, is based on the assumption on the one hand that the inquiry would be part of the issue of the coding notices and assessment forms and the like or whether you there envisage an independent exercise not taking its place as part of the system as at present operated.

-A: I think this is an independent exercise.

Q: Does it follow automatically that it must be? Suppose there were a given period of years in which it can be collected.

-A: We do not issue either returns or coding notices to everybody every year, so if we did it at either time what we normally do would have to be supplemented to a considerable degree.

Q: I am merely exploring the general aspects of it and I can see there are other arguments in favour of doing it as a separate exercise. But in terms of economy and lack of disruption, suppose it was said we will take three years to build that up before we start, could that be slotted in each year to deal with something of the order of a third with more economy and less disturbance?

-A: We have sent out returns to most people in a cycle of three years. We are now thinking of making that five. Coding notices we probably get out on average rather more than once every three years.

Q: I was thinking, particularly having heard what you were saying, about arrangements, particularly from your end as distinct from the payer or the employer's side, whether it would not be both less disruptive and a good deal more economic to spread it over the three years; is that too facile an assumption?

-A: No, I do not think so. I think that by spreading it like that one would have to do an exercise then to catch the third year people who may have moved after

the first, but certainly that would lighten the burden.

Q: I wonder if I could just raise one point. This is slightly outside the line of questioning so far which has assumed that a local income tax would be based on the place of residence. It is possible to conceive of an alternative model in which the rate of tax would be based on the place of work, and I was wondering if the Inland Revenue could comment on whether that would make the administration easier and whether it would make a substantial difference to the staff cost involved.

-A: Oh, yes, if that was a principle that you thought could be endorsed, then certainly it would make things easier, a great deal easier. There would still be one or two problems which perhaps I will be forgiven for pointing out. Most employers, I would have thought, would have a much easier job, certainly the small employer who draws all his work force from the same local authority area and if one is thinking in terms of 66 local authority areas there will be a lot where this will happen. There will, however, be a number of large employers where this will not happen. Take the Civil Service itself; we have nine districts in Cardiff which deal with all Civil Servants, members of the armed Services and various fringe bodies. You would have there, of course, to do a lot of splitting up, depending on the particular part of the country where an individual Civil Servant was working. Similarly, there will be Marks & Spencer who do PAYE for all of their employees everywhere on one computer, and there again you would have to split them up. Again there are certain banks and the railways. These problems may not be insuperable, but they would impose on those employers a job of splitting up which they would have to do. As far as we were concerned, we would just have to accept what we were sent by the employers. We would not have any means of checking. But overall, yes, it would be lighter.

Q: You were mentioning the burden

on employers, and I would like next to move to that rather difficult and sensitive field.

Q: This is your second paper. Could we just ask in relation to the 1:1 ratio estimate, do you have any idea in your own mind as to what amount of work would be required to improve on that estimate? You describe how it is arrived at. Do you have anything which tends further to confirm it or disconfirm it? Have you ever taken a view as to how much effort would be required to improve on the estimate?

-A: No, frankly, we have not. We have been recipients of lots and lots of grumbles about the weight of work, but the measurement of it has not been attempted other than the exercise which was done by management consultants as part of the tax credit preliminaries to which we refer. I am not going to suggest that what I am now going to say was anything like a thorough inquiry, but the managing director of one large firm whom I happened to sit next to at a dinner, said he was very willing to be a guinea pig for anything that we would like to try on him. I did try on him a local income tax, saying "What would it cost you in terms of extra staff if you had something like this?" and outlined the sort of thing we talk about in the red book. He came back and said, "Well, we have a computer and after we've done the programming it would not cost us very much extra at all". As to the absolute amount, what it now costs employers to do in the national context, I am afraid I cannot go any further, nor am I very sure what else we could do in order to find out. One has so many different types of employers of course. The computer payroll man probably does the income tax with other things, and as a marginal cost it might not be much extra. The farmer, the small businessman, who does it all rather laboriously with some large account books, it might take him quite a bit of time.

Q: With the computer chap, there are the costs which are essentially transi-

tional. They are the immediate costs of changing his programme, are they not? You say in your note that about 90 per cent of employees are employed by persons not using computers - at least that is how I read it.

-A: Yes.

Q: For them, using various forms of clerical endeavour for the purpose, would you see the problem as being essentially transition or is there a really substantial continuing cost?

-A: I would have thought there is continuing cost unless one adopts a scheme such as suggested. If for most of the employers one were saying "You have one rate only to add on" that would be relatively easy and there would be merely a transitional cost, but as long as one is envisaging the task of pay clerks looking all the time at a number of tables, this cost goes on.

-A: I do not think one should assume too readily that if any employer has got a computer it is all plain sailing. If he has got a computer with a bit of spare capacity and the programme will take this sort of stuff, that is all right, but a lot of people started off with smallish computers, their staff has gone up, they have had to put national insurance on as well and things have got more complicated, and the computer is fully stretched, and if you add a few more items to is they say, "My God, we've got to buy a new computer." Now it may be the old one is nearly worn out; but this has happened with national insurance changes already and there will be some cases like that.

Q: I think that is right.

-A: My guinea pig was a very atypical guinea pig; he was in the computer business himself.

Q: I am not quite sure I understand the 90 per cent on the bottom of page 2. Have I got it right? Are you saying that 90 per cent of employees . . .

-A: No. What we are saying is that of the total number of employers with payrolls, 90 per cent do not have computers.

Q: I see. I was reading this as an assumption that only 10 per cent of employees were on computers.

-A: I do not know if we have got a figure, but I would guess it is something like 50 per cent on computers.

Q: Could I just come back to this 1:1. It seems to me there are costs in the Inland Revenue, there are costs of employers, but employers include other central government. Is this 1:1 ratio deemed to pick that up? This 1:1 ratio is that deemed to pick up the cost in respect of Civil Servants other than Inland Revenue officials?

-A: I am sorry, you mean does it cover the chaps doing our own payrolls?

Q: We are told there is a 1:1 ratio between employer and revenue costs. Do employer costs for this purpose include the government as an employer?

-A: Oh, yes, including the Inland Revenue.

Q: Including the Inland Revenue in its capacity as an employer as well?

-A: Yes.

Q: At that point could I clear my mind on the general weight here, and indulge in a gross over-simplification for the present purpose. If I have followed the trend of what you are saying and what you have written, at the employers' end the critical question for them in terms of burden is not the residence issue, it is the number of rates?

-A: Yes.

Q: Their problem is made much simpler in terms of the number of rates. At your end it is just the other way round. The residence problem is the crucial issue for you and rates are relatively an easier matter.

-A: Could I just qualify that a little bit. Rates are an easier matter if we adopt the sort of scheme that you were talking about. When one has a disconnection between what is collected and what is paid over to the local authority then I think the problem of rates tends

to vanish for us. If one is making the connection, it is important.

Q: The relative weight to be attributed to the two main difficulties depends tremendously on which side of the transaction one is doing it from.

-A: Yes.

Q: You have mentioned the graduated national insurance contributions, and one of the lessons you learnt was that in some cases this was the straw that broke the camel's back in terms of size of computers. Did you learn anything else from this in terms of - whether impressionistic or otherwise - employers' costs or employers' resistance to incurring these costs or doing the job efficiently?

-A: I do not think so, no. I think there is a general grumble about any new burdens, but this happens I think whenever one gets a change. I do not think there were any particular new lessons.

Q: Could I ask whether this computer point is in fact a real point? For the majority of organisations which are dynamic in nature so long as long enough time is given then, of course, this is one of the things which has to be swallowed up in the system. I mean, in terms of an employer coming to you and saying, "If you do this to me it is a consequence", and it is a real consequence.

-A: Indeed, no, I think. . . .

Q: We could be led to thinking that if we were to have a LIT then all the computers in the country would have to be up-rated.

-A: No, I would not want to give that impression. It was simply that I think, as you say, one needs to give a certain time to make the necessary preparation.

Q: It would make a change but it does not mean. . . .

Q: That, if I have followed the general argument correctly, is for reasons quite separate, and a period of years would have to be taken as a mini-

mum. I am not quite sure whether your comment means or implies in any way that the period of years from the employers' transition in terms of getting ready to deal with the computer would be larger than that, if we adopt your own estimate of what would be a prudent span to allow. Could it be housed in that period? Let us say it was necessary to take five years from the time the Government said: "We're going for a new local income tax," to the time when you first began to levy. I was not quite sure whether your implication that one needed to give notice, on this point which my colleague was raising, implied that it needed to be longer than the period that would be enforced anyway.

-A: I think it depends very much on how much you say at the beginning of your period. Our experience is that unless computer users have the ultimate picture fairly well spelt out right at the beginning, they will not do anything. They will say: "What's the good of my starting?" So on your time limit of five years, if you said precisely at the beginning of the five years what you were going to do, yes, this is an adequate time. If you only said it in general terms and only spelt out the details in year four they would say, "This is not enough."

Q: Can I envisage a programme and see whether it fits in. I suppose one possible sequence would be if the Government said in principle it wanted to break down rates, it felt obliged in the foreseeable future, it would then have to say to you, if I have followed your papers aright, "Now we've got to have a real estimate. Here is a draft scheme. Our cost is . . . Tell us about time and everything else." So it would have a little later then to say, "Now we are adopting a view and it is based on this scheme and that process", if you then said five years that would meet your requirements?

-A: Yes, if it was spelt out in that degree of detail.

Q: These are the principles on which. . .

-A: It would have to be more than principles I think. You would have to have principles plus a fair degree of mechanics.

-A: If I could give an example, the Government hope to introduce a new pension scheme in 1977. In order to get it working in April 1977, the detailed specifications have to be out to industry by this summer. Now the changes are not all that far-reaching but they do imply deductions from pay on a rather different basis from the present ones, but nothing like as big a change as a local income tax would entail. It would not, we hope, require people to buy new computers. So I think one has to add two or three years to that sort of figure for the specifications to tell employers just what they have got to do.

Q: Was there a long lead time given to employers for the graduated national insurance contribution?

-A: That kept on changing for various reasons, and I am not sure precisely what the lead time was in the end.

Q: Like a fortnight!

-A: No, not anything like that. It has to be getting on for two years, that is the minimum. The forms have to be agreed. We have to say the forms meet this specification and that specification, and we have to tell them that slightly less than two years before.

-A: And that came in in 1960.

-A: Ah, that one, yes.

Q: I meant the recent one.

-A: The earnings related one came in in 1975. I can look up the dates, but the lead time was of the order of the length of time from this summer to April 1977.

Q: Now could we move on to your document and costs of staff and administrative problems.

Q: You are making a mark-up for overheads which is of the order of 35 per cent. I am not sure that I fully understand – it is on page 4 – where you say that the costs given – that is the earlier figures – were purely staff costs,

without any addition for overheads; a full costing, including all administration costs and overheads, would increase the figures by some 35 per cent. But that 35 per cent includes the cost of the further staff?

-A: That would be superannuation and accommodation.

Q: Personnel management and so forth?

-A: I am not sure. It would probably have some supervision in that.

-A: I imagine so.

-A: But superannuation is quite sizeable. It is 15 or 20 per cent or something like that.

Q: Is this 35 per cent cost a marginal cost or an average cost or what?

-A: It is the way the Civil Service Department approve in these things. One takes an average salary of a grade and adds to it a percentage. I had not realised myself, I confess, it had gone up as high as 35. It was somewhat lower when I used to deal with such things. But this is an addition which represents not a marginal cost but the real cost of the superannuation for that extra chap you employ, and the cost of housing him and other incidentals which are smaller than those two elements.

Q: Can we just ask a little about your record on costing, and you will have some idea as to what your own record is. I myself was at one stage familiar with the Inland Revenue making estimates of the cost of doing particular things for the purposes of budgetary decisions. Have you done any checking of your record as to how far your estimates have in fact proved to be reasonably accurate or tended to be over-estimates or under-estimates?

-A: When we are doing something which we are familiar with, increasing the personal allowance, doing a job of that kind, we are very accurate.

Q: A one-off job as it were which you are familiar with.

-A: Yes. If the Chancellor says: "I am putting up the higher personal allow-

ance by £X and the child allowance by £Y," we are able to say pretty accurately - we do that by overtime - how many million hours of overtime we want for that operation because we are familiar with the operations involved. I think with something like this which is new where we have to guess to some extent, to visualise a new kind of operation and then put a factor to that operation, and then the estimates got a little rocky, but I would not like to say that our estimate, if wrong, is likely to be excessive or deficient. In that field where we have had recent experience of a new tax, capital transfer tax, for example, we see no reason as that has developed, why we should alter the original estimates. They have not been bad.

Q: Could I be clear about the superannuation. You say superannuation is a very high figure these days; 20 per cent may be on the low side. If the 35 per cent contains the superannuation element, then the rest is a very small figure in normal on-cost terms for the kinds of additional costs to operating costs.

-A: Yes. I am sure that there exists a breakdown for this. We would not have used the 35 unless there was. Can we send you a note?

Q: That would be very helpful.

Q: Either way, it looks a little surprising.

Q: I think it is fair to say, as far as I know, ICI have 60 per cent.

-A: Do they? Perhaps you house people better than we do.

Q: Using the guidance in your note, it looks as though a local income tax scheme on the lines that we have put up for discussion might have an annual cost to the Revenue of £70-75 million, that sort of figure, to collect, say, £2,000 million which is somewhat more than the domestic rates at the moment. That would be a little over 3 per cent to the cost of collection, ignoring of course cost to the employers for this purpose. Can you remind us how 3 per cent compares with your cost of collection?

-A: Double the income tax cost. It is about double. The figure in my mind is about 1.75 I think, our overall figure for all taxes. It is in that area. We split it between the direct taxes in our annual Board's report which we have not brought with us, but it is about 1.75 overall.

Q: Could I ask something in that connection. This is very difficult notionally, but I think it is something that people will have to ask themselves. Let us assume that the 3 per cent is absolutely right, perfectly correct, at the institution of the new tax. Is one to envisage that when a new system has been introduced for a few years and ways have been found of cutting corners, streamlining it, and knowing how to organise and all the other things that tend to happen when one is administering something new, by re-organising it on a more logical basis, that it would necessarily stay at the 3 per cent level, on the assumption that I have made?

-A: I think it would stay at the 3 per cent level if you did not alter the methods radically. But we would—referring again to the computer—see that this tax was put on as well and one can see that in common with the cost for income tax, national income tax, this cost would come down too, but I do not think it would come down independently of the computer. So long as it is manual it would stay at this figure.

Q: But there would be an obvious desire to try and bring it down to something nearer normal tax levels?

-A: That is not so much a function of the staff you are employing as the amount you are collecting. The reason why the national income tax looks relatively cheap is that we are collecting so many million pounds. It is that part of the fraction I think rather than....

Q: I accept that that may very well be a reason for thinking that we will not get it to that level. But as a layman I have seen quite a lot of estimates by

large firms of what it would cost to do something, because we needed to know for arbitration or other purposes, and in the event it has often come down after the first year or so as ways were found of doing something once you had got the actual job in front of you for which you could not design so efficiently when it was not so well defined.

-A: As with national income tax, there would be a constant endeavour to lower costs, but I think I would be misleading you if I held out real hopes that it could come down appreciably. Of course 3 per cent, compared with 1.75, the other figure, looks large, but one cannot disguise that other new taxes have been introduced in recent years and others contemplated where the cost is going to be higher than 3. The cost of the wealth tax, for example, on all the figures put to the Select Committee, is higher than that.

Q: Is there a documentary estimate for that?

-A: We put in a paper to the Select Committee, which if it has not been published will be, and it may well have been. We can send you a copy.

Q: I think it would be helpful. Obviously we want to see the whole range of taxes.

-A: We are thinking there in broad terms of a staff of something like two and a half thousand with a yield of two hundred million. That is the sort of picture.

Q: I do not want to take your time now but anything that helps us to put this in the setting not only of the lowest cost but the range of costs would, I think, be very helpful. Nothing elaborate, just one sheet.

-A: Certainly.

Q: But in doing so could we have the absent figures as well as the percentage of the estimated yield. You see, if it cost 5 per cent to collect the wealth tax, whatever the other merits of the situation, 5 per cent of two hundred

million is a much smaller sum than 3½ per cent of two thousand million. So that relatively too is important.

-A: Of course.

Q: As well as the ratio of actual cost, the yield.

Q: Could I be clear about the longer term following the earlier question. It is that whilst 3 per cent is an estimate on the kind of brief that you have now, a new situation would in fact arise over a time in which it would be difficult to separate out the cost of LIT versus national income taxation because you would have gone into a different data processing, different organisation situation in the long term; is this fair?

-A: Yes. We have got plans fairly advanced for computerising all NIT and if we visualise a LIT as well then that would certainly be taken into the plans. We would hope, having been engaged in this since 1957, that it would not hold us up further.

Q: Would it be right to say that subject to further computerisation and because of the high staff content of this activity, the presumption is that relative cost would rise?

-A: I do not think that the relative cost would rise expressed as a fraction.

Q: No, I am sorry, because of the phenomenon known as relative price effect, unless you computerise your effective claim on resources will be increased for tax collection generally, including this activity?

-A: Yes, that is true I think.

Q: This is a five year view and one has got to assume that resources including manpower can change in the nature of time, but what if you had to introduce this thing very rapidly, let us say, even in four to five years, would you see there being major bottlenecks in getting the manpower necessary?

-A: Oh, yes. Our annual demand—again I speak off the cuff and I would like to see the actual figures later—is something like 4,000 staff just to meet increases plus the turnover which is

quite considerable. To think of that expanding fivefold is really a bit fearsome, in that one year when you have got to recruit the bulk of this extra.

Q: The salary grade that you are talking about, at £2,000 a head in 1974 seems extraordinarily low to me.

-A: Clerical assistants and tax officers?

Q: This is mostly clerical assistants. So by implication therefore there is not much skilled labour required for this. You would want some supervisory people but not highly skilled people?

-A: That is right.

Q: So your claim is on that rapidly diminishing pool of people who can read, write and do arithmetic, but do not aspire to much more?

-A: Yes, the five O level school leaver, who does not exist now. A diminishing race, yes.

Q: Can I approach this from a general point of view, and I would like if I may to test it on two quite separate postulates, either or both of which may well be real at some stage. First, that Ministers are faced with a situation in, say, the rating field which makes them say "We have now to take a decision on whether or not we move from rates to something like LIT" and they know no more about possible variants than, say, your papers and ours have canvassed already. They have therefore a few sketchy models, they may have a list of general principles, they may have a broad idea of the objective, the purposes, and they have some relatively clear picture of the tax incidence, all these general matters they are going to want to have before them, but they are not in a position in any real sense to sketch out more models than those which you or we have canvassed at the moment, but because of the long time lag which will follow any decision, they feel the need to make a decision now.

And the second position is that they have made a decision to move to local income tax, for whatever reason, and they now want to decide what steps

they will take next. Now if I can go back to the first question, one of the things that give me some anxiety is your very understandable and justifiable comment that it is frightfully difficult to cost this until one knows with some detail what will be the steps showing the numerous detail that would be needed to give a reliable estimate. The Ministers presumably in the first situation would ask this "Well, we have had all these papers. Can we regard these costs" - the sort of costs that my colleague was mentioning a moment or two ago - "as giving us a pretty fair indication of what any feasible scheme would be likely to involve so as to enable us to say we have got a good enough bracket here to enable us to take a policy decision". I imagine in those circumstances they would say to you, "Well can we take it with reasonable safety?" Unless something quite bizarre is produced, this gives us the order of magnitude. Or is it reasonably likely on the other hand that a sensible, feasible scheme, with no bizarre elements in it, and not in principle hitherto forecast, could produce a cost radically different in the present situation? Now if that question were raised in that context, what would your answer be?

-A: I think first of all on the sort of sketch of the plan that you have given we could confidently say to Ministers, "Yes, the cost is something like this, slightly up, slightly down, but in overall terms about right." You mentioned the word "bizarre variation"; one can think of certain variations which would not be bizarre but might make a considerable difference, simply because of the numbers that might be involved. For example, what one did with the married woman at work. If one had some initial idea of aggregating husband and wife on the one hand, or treating them as separate individuals on the other, because of the numbers involved a variant there might make a significant difference to the cost figure. But minor variations, bizarre or not, would not make all that difference I think. I am sorry, I have lost the second part.

Q: No, I have not got to the second yet. I thought we ought to canvass the first first. Can I just follow a little further. On your first answer, very broadly speaking, subject to later modification . . . [inaudible] is a good indication of order of magnitude, give or take a little. Without being particularly precise, but so that I have some idea of what that means, when you say give or take a little what does that mean? Plus or minus 5 per cent? What sort of margin?

-A: Yes, I was thinking in terms of about a thousand which is about 5 per cent.

Q: So plus or minus 5 would be a useful indicator?

-A: I think as useful as we can possibly give you, yes.

Q: Then may I move on to the second qualification. You say if some not necessarily bizarre but some complicating element in the way a particular feature of the scheme was handled or a particular distinction made which involved more work than envisaged in this scheme, you would have to alter it. Take, say, the point about married women, again what sort of order of shift are we talking about if some special approach of that kind is instituted? Is it possible to give any indication of the order we are thinking of?

-A: I would have thought if one was considering, say, the idea that married women were to be treated quite separately as individuals, then the addition that might have to be made is quite considerable. I am thinking now in terms of four or five thousand.

-A: There are some four million working wives. One has to link all those with the husbands.

-A: You see, there are so many things that one has got to think about here that would make a difference. Say one said first of all that in this year, of all years, the woman ought to be treated separately, then which women and which income? First, everybody says their earned income which for tax purposes is separable, but if one was really

pursuing this concept one could say, "Well, take their investment income out as well". Then one has the problem what is the husband's investment income and what is the wife's, and all sorts of horrible problems of this kind. Who is paying the life assurance premiums, is it husband or wife, and a lot of problems of that kind.

Q: Can I assume for fairly obvious reasons for a moment that we are in the situation of the first postulate, that Ministers say, "Well, whatever turns out to be the final nature of the scheme we will not accept or support a scheme which alters the general philosophy, the general definition, the general approach to taxation matters, enshrined in the present income tax system, except for the two principal factors, namely, attaching tax to residence as distinct from place and mode of employment, and in terms of the fact that one may or may not have a variable rate, not parallel or simultaneous or linked to the national income tax rates. If those were the two central principles, would it be right then to assume that the £70-75 million, plus or minus five per cent, gives us a pretty reliable bracket?

-A: That would be right on the basis that one does not have discontinuity between the payment and it ultimately finishing with the local authority. We have given you a figure for the idea that you put to us before, that one has a scheme which is rather less accurate and what is handed over to the local authority is a computed sum out of the total amount taken. That would cost less.

Q: In the second situation it would help me at any rate to be clear in my mind about one or two things. You will remember the second postulate was that Ministers have said for a variety of political and administrative and other reasons that, "We are of the view that we shall move in principle to LIT but we are not wed to any particular scheme". I do not know whether there is material on which to answer this. I find it a little difficult in the present

state of the papers to know how they would reasonably be expected to proceed. Would they say: "We have an estimate here of some schemes; we must decide on that one," and ask you to work it out and develop it, or would they say to you: "Now you go away and produce a scheme for us that answers to the central tests" I described a minute or two ago and said it does not depart more than necessary from philosophy and rules underlying the income tax in this country and would they have to wait until they had that detailed scheme before they could say, "We can see clearly enough what the general burden will be, what sort of resources we are devoting to the task"?

-A: You ask me a very pertinent question. I think in the last two or three years we have evolved five new taxes. In none of those was the approach on the second basis. It was much more: "We are going to have such and such a tax; now tell us how to do it." So recent history would certainly say that this would not be the approach.

Q: Does it follow on that footing that your estimate here on the sort of models that have been put forward, on the hypothesis I have just mentioned, namely keeping as close as possible to the philosophy of income tax but varying it only to the degree necessary to achieve the two central purposes I was mentioning, the Ministers in fact might be rather better off to have an order of magnitude and estimate of resources in this instance than they have in the last decade or so been able normally to obtain before making that decision.

-A: Yes I think so.

Q: Could I just pause a second. If we take what is comfortably known as the McIntosh model, and if we take your estimates of costs, and double them up for the costs to employers, we are talking about something which might be between £120 and £150 million as a measure of resource cost at today's prices. If we take the, as it were, Inland Revenue model without the McIntosh adaptation, it is more like £180 million,

by the same sort of reasoning. Now I have got two questions. I think these are enormous sums frankly and only rather major gains would justify them in some sense, but would it be fair to say that if Ministers really wanted them then on the recent record in office of both Parties they would be prepared to swallow estimates of this kind; that is the first thing? Secondly, do you think that the difference between the one estimate and the other would make the slightest difference to anybody's decision?

-A: My answer to that would be yes to the first part and no to the second.

Q: Can I take that line of consideration a little further. Again having had a number of recent tax changes which we have reacted to in much the same way as you have, can I follow this line of thought. I go back to the point I was making a moment or two ago about what one has seen of business associations which have naturally and cautiously allowed for unexpected features but as the thing has worked out the estimate has tended in reality to be somewhat lower because ways have been found as you get closer and closer to the detail of cutting out difficulties, running two steps into one and all the things with which you are more familiar than I am. Now given the model that we have advanced this has had a result of moving the staff estimate down very usefully from 22,000 to 18,000. What I wanted to ask you was this: I suppose one could imagine three possible circumstances, going back to my second postulate, that Ministers had said, "Right, here's a rough model, it is good enough for us to make a decision on it whether we accept the general pattern. We accept it and now will you please develop on this or any other model you like as a feasible local income tax but answerable to the same tests." Is there any means of assessing whether on the one hand you would make the assumption at any rate at the beginning that the result of your analysis would be likely to lower the cost as you began to work on the detail, whether it would be

neutral, or whether the consequence usually is to increase the cost as you begin to understand how the detail would fall into place?

-A: I would have thought it was neutral with a tendency to increase.

Q: Can I turn the question round another way now. In looking at these matters as things stand at the present, are there any other ways in which while answering to the general tests, you could see the scheme being modified in such a way as to make a further reduction in costs of any material kind?

-A: It depends on what are regarded as inescapable premises I think. If, for example, one was not tied to the idea of a variable rate but there was some increase over and above the present income tax rate, which in some sort of way was then segregated in the national accounts and passed over in the form of a grant, then I think the sort of estimates we are giving would be cut quite appreciably. I think it is the variable rate both on our side—it is more limited with the McIntosh formula—and more particularly on the employers' side that we visualise as causing the greatest single amount of additional work.

Q: The multiplying factor?

-A: Yes.

Q: I am not quite sure I understood the first part of your postulate. I think I understand what you say about the difficulties. Would your simplification then that that postulate would make a substantial reduction, would that mean that you had to envisage a fixed rate? I am not quite sure what in practice your improvement, in the sense of saving effort and resources, would involve.

-A: What I think I was describing is much more like an assigned amount of revenue than anything that you have been talking about so far. Somehow an extra amount of revenue had been raised instead of the rates, and that is then handed over with any other grant either on the present model or modified,

to the local authorities as a sort of combined rate plus grant but coming not directly from the individual as now but from Whitehall.

Q: But that involves, does it not, effectively a flat rate however one described it?

-A: I think it does, yes.

Q: A layer of the cake is earmarked by a stated rate or by a portion of the stated rate?

-A: Yes.

Q: Could I ask two points about the variable rate. Would there be any appreciable difference in the costs if the number of variable rates was limited?

-A: Oh, yes. You remember there is a paragraph in one of our papers in which we talk about the number of tax tables that have to be issued. I think, looking at it again, I would like to modify that particular paragraph a bit even as it stands. We have indicated there that one would have to have a re-issue every time the basic rate changed of the whole set of tax tables, and that this would slow the whole matter up. I do not think that would be necessary. One could have a range of all possible tables and if the rate went up rather more than we visualised then one would be printing tables at the top end, and not the whole series again. So I think to add that to your question, the fewer rates one has, the fewer sets of tables to which employers would have to refer the better.

Q: But would this make an appreciable difference in cost or are we dealing in very fine margins here?

-A: On the employers' side, yes, but here as we have indicated before we are in very difficult territory - this one-for-one ratio about which we are not terribly certain anyway. All we could say I think was that if you had half the number of rates you would probably halve the number of people in employers' offices, because the main thing we would expect them to do is to look up tables.

Q: So the number of rates is significant?

-A: Yes, indeed.

Q: The frequency or the time span within which rates are varied would it make, again using the word appreciable, difference in costs, both of yourself and the employer if the time span for varying rates were different? At the moment one thinks in terms of a year. If the time span for varying rates was, say, three years, would this make an appreciable difference or is it just an awkward hump?

-A: No, I do not think it is awkward. The crucial thing here is the time of announcement of the rate rather than its duration. We would have to have the rate announced and known by the time we were beginning to write coding notices for PAYE for the following year, which is about October.

Q: If we take these two things together, the number of variable rates and the frequency of, say, three years instead of one year with a proper time allowance for the preparation of them, would this make any significant difference to the order of costs?

-A: I do not think the duration would make much difference. The number of different rates would, I think, affect employers rather than ourselves. Our time would be taken up in looking at the man's residence, seeing what rate that particular local authority charged, putting that particular figure as a part of the code number which was then sent out. This would still have to be done, whatever the duration. The man may have changed his residence within the three years. So I do not think you would cut down the time very much there. You would on the employers' side.

Q: When dealing with the question of how many variable rates, and you gave the answer "Yes, that is of great importance" if I followed an earlier answer you gave to a question I put, it is absolutely critical for employers' positions how many rates there are?

-A: Yes.

Q: It is the central factor as far as the burden on him is concerned?

-A: Yes.

Q: I perhaps missed it earlier, but can you tell us how many rates you did assume?

-A: In paragraph 3 of paper 2 we say this would require up to 10 times as many tax tables; what we said was 5p in steps of half a p.

Q: Could I go on to another point. At an earlier stage we were thinking how to transmit to employers the variability. We did consider the possibility that this should be done through a reduction in allowances as opposed to a set of variable rates. Essentially that a local authority would declare a negative amount of allowance which by some process got itself on to the notification of coding, so that when it got to the employer the employer knew nothing other than his usual receipt of a coding reference. He would no longer have to know anything at all about the variable rates. This has got very awkward problems in terms of regressiveness, particularly up to the limit of the basic tranche. If such a thing were feasible in regressivity terms, would that make an enormous difference on the employers' costs?

-A: It would not make any difference to the employers as compared with the present system. From our point of view, I would be a bit horrified about that very largely because of the old age pensioner.

You have a person with a job however small plus the national insurance pension. Now at the moment we deal with the tax on the pension plus the wage by calculating a man's allowance and deducting from the allowance the amount of his national insurance retirement pension, and giving him what is then a fairly small code number representing the balance of the allowances. If one was going to eat into the allowances to any degree to reach a situation in which that difference disappeared, and then one was going to have to make

assessments on the retirement pension itself, because we could not accommodate it in the coding this raises very difficult problems, does it not? We are running into this now.

Q: Say, for example, we considered that LIT was a partial substitute for Rate Support Grant, and as a result in theory at least central government would require less general taxation to compensate for the lower amount of Rate Support Grant, so that we were able to increase the allowances by, let us make up a number, £500 to allow for the reduction in RSG, and then set a limit in negative allowances that local authorities could promulgate such that by definition it could not exceed the extra £500 plus the single person's allowance. If we could overcome this problem of eating up all the allowances by that sort of procedure could it be a starter, and worth your while thinking about it?

-A: If the Chancellor did have that amount of money to play with, he may very well decide not to increase the allowances but to reduce the rate.

Q: I think the proposition put forward by my colleague is an attempt to eliminate completely the cost to the employer, and to that extent the Chancellor would have the choice of either reducing the rate of local income tax and the cost of local income tax, or of doing it. . . .

-A: Yes, what it would mean in fact as I understand it is that the single person's allowance and the married person's allowance - I can see another problem cropping up here - would be reduced on a variable basis depending on the value of the ratepayer's residence. The problem here is again married women at work because that allowance is always the same as the single person's allowance and you would be giving that relief twice.

-A: They would both pay local tax, presumably.

-A: Here again it is difficult.

Q: There is no reason why they should. If you follow the basis of

income tax and not depart from the present principles more than necessary it would not follow that you would have to do that.

-A: It would. You see, at present the reason why the married woman at work gets the generous allowance which she does is that she must get the same as the single person's allowance by the mechanics of the PAYE system, otherwise the whole system breaks down. One could not avoid this I think. So one has first got to make the decision that both the husband and the wife pay if the wife is at work, but not presumably if she is not.

Q: Could I go back to one or two earlier points. I may have misunderstood the situation, but I rather gathered when we were in Liverpool the problem of the old age pensioner when they issued the allowance loomed large, and was a fairly large scale problem which you foresaw having to be dealt with anyway. Did I misunderstand that?

-A: Well, the age allowance has helped. -A: We were very worried about this. With pensions going up and allowances going up not so quickly it is becoming harder and harder to code out, as we say, against any Pay As You Earn source. I agree this is a problem that we may have to do something about; quite what we shall do about it I do not know. One possibility is that we collect tax by what we call the direct collection system.

Q: What is that?

-A: It is instead of Pay As You Earn. We make something like a Schedule D assessment on the national insurance pension; the pensioner has to pay so much direct to the Collector. If we had to do this on a large scale the prospect would horrify us, and we are considering what we can do about it.

Q: Is there any known answer at the moment?

-A: No, short of putting up allowances, sufficiently to get us out of it.

Q: But no administrative way is apparent at the moment?

-A: No, indeed.

Q: I think we can return to that topic.

-A: I think it might be helpful if you had a paper on that subject.

-A: Could I just add that given this background anything that reduced the allowances would obviously make it that much more difficult.

Q: It is clearly something we would like to explore if only because quite separate from the question of burden on employers generally speaking and further work of this kind, the problem of the small business end is obviously a particularly sensitive one and since this would be replacing a tax which amongst other things is vociferously and vigorously criticised because of its effect on the small business, it would be rather a curious exchange if we made the problem bad or worse for them.

-A: This is in respect of their business premises?

Q: In respect of their business premises in one sense, but their mixed hereditaments in another.

Q: Or coming in alongside it, which in a sense compounds the problem.

-A: It depends what you are going to do with commercial rates generally.

Q: I wonder if I could just return to a point I made earlier as to the difference it would make if one relaxed the assumption that the tax rate had to be varied by the residence of the taxpayer and went to a basis on which it was varied according to the area in which he was employed. I was wondering if it would be possible to give an estimate of the cost of administration on that sort of basis? Presumably that would take it outside the 5 per cent variation in cost that we were talking about earlier.

-A: Yes. We would like to think about that one because you have got all sorts of problems arising there, about people with mixed incomes. There are quite a few people who, for example, are employed and carry on a business, however small, from home. If you charge

him at his work place what do you do about the home? Does one have to determine which is the dominant source of income, and only give that local authority the right to charge this particular thing. So I think we would like to think about this particular one.

-A: From our point of view of course, the simplest thing – but I do not imagine you would regard it as acceptable – would be to say look at the tax office which deals with the company's payroll, wherever the chap works. Then, of course you would get everyone working for Marks & Spencer or Boots paying tax at one rate according to where the payroll happens to be done.

-A: Not only that, but you get rather cross local authorities if the employer suddenly builds a computer somewhere else and transfers the payroll there overnight.

Q: Of course the payroll centre would be easily defeated because everybody would quickly move their payroll centre to the lowest.

-A: You have not altogether lost his difficulty about residence because you have all the investment income and all the business income also to deal with somehow.

Q: Now I wonder if we could move on to a slightly shorter problem, and that is the problem of self-assessment which you deal with in Section 5 or Paper 5 of the papers you have sent us. There are one or two matters I would like to raise about this matter, and in your first paragraph 7.1 you rightly draw our attention to the fact that one of the features of many if not all of the systems where self-assessment is wholly or mainly employed you need to have pretty stiff and mandatory penalties so that people are discouraged from the rather more loose approach to their returns than they might otherwise enjoy and you say there is no precedent for that in this country. If one were turning to a local income tax of course one would be starting a system which itself had no precedent.

-A: Yes.

Q: And I wonder just how serious you feel the obstacle would be to making a major change of that kind, to say as this is operating on different principles it would require a different approach to penalties.

-A: I think there is something tied up here with what you referred to as social habits earlier on. There seems to be a feeling in this country that tax tends to be more or less a voluntary contribution unless one is under PAYE, and that type of thinking persists. I was reading only last evening the Committee Stage debates on the very moderate proposals that have been put forward in this year's Finance Bill whereby people who are late in settling their tax should pay interest at a commercial rate, and this has produced all sorts of violent reactions.

One perhaps expected some opposition but the reaction has rather been more than somewhat. I am sure if you used something other than commercial rates you would have to have penal rates in order to attract money in. There would be quite an outcry in the first place. This may be something people get over and accept, but I think any Minister would have a very rough time and Ministers do not like rough times.

Q: On the same page you rightly comment on the foreseeable snags. What I did not quite appreciate at the end of the paper was whether you are saying, "Well, looking at this from the point of view of what we have to handle and we are familiar with the situation, this really is not a serious candidate for consideration", or whether you were saying, "Well, we must obviously consider the snags and there are difficulties but it's a serious possibility"; I was not quite sure at the end of the day what the balance was.

-A: I think we were trying to say that rather to our surprise – certainly to my surprise when I read the paper – what had started out in our mind as an attractive approach was very costly. My colleagues know I questioned them quite a lot about how we got to this figure. It was because of that we were

trying to say, "There are attractions about this but look at the cost"; the cost rises. In short, it seems a paradox that now we have a system which is not self-assessing but we are suggesting to you that self-assessment should cost so much more. The reason—and it can be expressed quite shortly—is that at the moment we are only going to perhaps two million people to collect taxes directly—perhaps that is a slight underestimate but it is of that order—first of all a million employers who are paying us PAYE and secondly about a million people under Schedule D, the self-employed. Self-assessment means that one has to collect from 25-30 million people, and that raises entirely new collection problems, and I think that accounts for the very large collection element in this 54,000. It is more than half.

Q: I suppose one must ask the related question, must one not, would it be any more feasible if the whole income tax, local income tax and national income tax, were to be based on the same situation? You go over wholly to self-assessment on the income tax side.

A: I think one would have awful difficulties there. At the moment the greater part of income tax comes in comparatively easily through the employer by deduction of tax at source. If one was collecting directly on a self-assessment basis from 25 million people, one has very great problems of compliance. Having said that, I should add that in the United States they have a system of deduction of tax at source on a very rough basis, associated with a self-assessment scheme. The trouble about our PAYE system is that it is much too refined and sophisticated and no other country has a scheme like that, but no other country incurs our costs. The difficulty is that we cannot retreat from it.

Q: Now I wonder if we could move on to the matter of distribution.

Q: On the assumption that LIT is introduced and the Inland Revenue are fully responsible, we would like your

help on this question. It is a question you might well say is for us to answer, but we would like your help. Once the Inland Revenue have the money, should this distribution be on a precise basis, as a collection from individuals, and looking to the example we have of distribution via the RSG achieving equalisation would it be sensible to distribute in a general way but closely related to the local tax rate?

A: Can I split that into bits? I think first of all one might have certain problems. I think it would be easier in many ways for this disconnection method of distribution to take place than perhaps an accurate one which is based on a residence test of some antiquity. If one was looking at where a person was a year ago, 18 months ago, and then trying to tie a precise amount of tax which one handed over to the local authority to that I think one would get complaints from local authorities which were growing. One thinks of a new town, Milton Keynes, or somewhere like that, which is going to grumble because there they say in this present year where we have to meet rising expenditure we are only collecting something which is based on a smaller population a year or 18 months ago. To that extent I think the discontinuity method, the handing out of the money, in a broad way on the basis of current income assessment would reduce that degree of complaint. I would have thought it was helpful in that respect to have discontinuity.

As to the basis on which one actually divides up the pool, I am not quite sure what you feel about the present method of grants determined by (a) needs and (b) resources. What we could do and what I think has been visualised so far is for us on a sampling basis to try and say what the current income is, the total income arising to all residents of a local authority, and to distribute the money in that proportion. It is going to be very much a matter for you as to whether you say that is a way preferable to the present grants basis, is it not? I would have thought it had some virtues.

Q: One could approach it on two

bases, could one not? One could look at the problem in that way, and one could also say in fixing the limit of what can be raised by way of tax through local income tax as an upper level, simply distribute straight to the authorities those particular amounts that are attributable to those areas. We will leave the grant on the basis that it would still be a grant to be effectively distributed. It would make your task much easier.

-A: Yes.

Q: Provided the ceiling did not rise too high.

Q: I think this is the core of it. If it is easier to distribute LIT than it is to distribute RSG or whatever is left of it, then we are going to have two bunfights instead of one.

-A: Yes, but if you made the LIT distribution, as it were, simply a mathematical concept, that is, if you relied on somebody to say the total income in this area is so much, and you charge 4p or 3p or whatever, you at least reduce the number of bunfights, do you not? It becomes automatic.

Q: Could I raise one other point in this connection. When those of us who had the pleasure of going round your offices in the North West were talking to our colleagues about what we had seen and learnt on our visit, Lord Ridley raised the interesting point which I would like to raise with you, which unfortunately we did not take into account when we were visiting the offices. He said that at any rate in some parts of the country the Post Office have still retained in their coding and addresses and the way in which they do it a pattern which was appropriate before the reorganisation, and what was described as Liverpool or Birmingham or Newcastle might now be or not be within the authority's area, and the problem therefore was if you had an address which said it was in a certain place, (a) the county might not exist and (b) it might not, if it still carried the county name, necessarily still be in Avon or whatever, or whatever the county given

was. He said what effect does that have upon the capability of the Inland Revenue if they collect local authorities' income tax on a stated residential basis in knowing to whom to attribute that tax? This is not a point we have raised before; it has only been mentioned a day or two ago. I wonder if this has been considered as far as you are concerned on a distribution basis.

-A: We did not really feel that this presented a problem. What we had in my days in tax districts were very elaborate parish lists where one could go to an individual, follow him through to his street, thence to a parish, and thence to a particular local authority. I would have thought something of this kind - parish lists still exist do they?

-A: I am not sure that they do.

-A: I would have thought the postal code is too uncertain. I was reading in the newspaper that one of the Post Office economies might well be to abolish that.

Q: Received with rapture by many other people than the Post Office! May I turn now to matters relating to miscellaneous aspects of local income tax; those are tax allowances and tax credits.

Q: This really assumes that the rating system continues. I think I should say that what we have been toying with is firstly the idea of removing the criticism that the domestic ratepayer does not get any tax allowance on the rates he pays, and also the possibility that if one substituted a tax allowance then one might possibly be able to substitute tax allowances in domestic rate relief, and then going still further than that one might be able to work out a scheme where you got automatic rate rebates rather than the present system of applying for them. We gather from your paper that again this question of linking residence with the ratepayer is one of the major difficulties you are going to encounter. It seems to me we dealt earlier with the same problem. It did occur to us really that there might be some system here whereby the local authority could notify the tax office of the ratepayer's name

and address, and that there is a reasonable parallel here with, say, building societies. We wondered whether this is a feasible proposition. There are about the same number of building societies as there are local authorities and I do not know whether one could work something out in this respect.

-A: I would have thought that the major problem here even before you get to that one, if I may say so, is the philosophical one, that is to say, you are not helping the right people by doing this. You suggested that one might give an allowance and therefore meet the present rate relief. . . . I am not quite sure?

Q: Domestic rate relief.

-A: Yes. What one would be doing on anything like this is not relieving the person who ought to have relief, that is the person who does not pay tax because his income is too low, and relieving almost entirely the more well-to-do people who might very well be paying at 83 per cent or indeed 98 per cent. It would have rather the opposite effect, would it not, to the sort of thing that you desired. I would have thought that is a problem to tackle first.

Q: One suggestion we have had in that respect is that there should be an upper limit and probably the allowance should only be made at the standard rate. Does that raise complications?

-A: It would certainly better meet the particular point that I had in mind although one is still not able to relieve at all, or one must relieve by some other mechanism, not in the tax field, the people who do not pay any tax at all. I would have thought that on the general point the residence problem is probably not a major one. With building society interest, with which you quite rightly drew a parallel, a claim is made on the income tax return and this is fortified by a return which we get from the building society which will be parallel to what you have in mind for local authorities. We then give in the coding relief for building society interest which is due, correcting that at the end of the

year, which is sometimes a very great problem. If you recall a recent year - I have forgotten which one it was - when the building society rate went up from something like 8½% to 11% - 1973/4 I think it was - we had four and a half million repayment claims to make at the end of the year. This suggestion will only work if you can get the relief right in the coding, otherwise it is an enormous end-of-year task.

Q: Does this assume this only applies to people making an annual tax return? What about the people who make them every three years?

-A: What happens there is that we pick them up. I think I am right in saying that what we ask for in the return is not the amount of interest paid but simply the roll number and the building society so that we can go from the return and get the actual figure from the society. Here again one assumes a similar mechanism and one would ask on the income tax return for the particular local authority to whom the rates were paid which would then connect with a return which we would ask local authorities to supply and that would have to be on the basis of an estimate if that were possible. We would work the estimate into the code number and give relief that way. We have done a costing of this without the limit which you suggested and certainly without limitation to basic rate. It was something like £600 million. It would be quite a costly operation. Less of course if there are limits.

Q: Would the limits complicate the issue or make it simpler from your point of view?

-A: Everything other than relief on the actual figure that is paid complicates the issue. I think it depends very much on the limit that you set, certainly the upper limit. If it was high, the same sort of order as the £25,000 for interest relief it would complicate it but not much. The basic rate limitation would be rather more of a complication because - I am sorry, I do not want to be too technical - the tax tables which are used

for PAYE incorporate the higher rates, so that if one was using a code number in some way one would be giving automatically relief at higher rates unless one corrected it in the code number by some mathematical adjustment, and that would be a nuisance.

Q: The other ploy we were thinking of, which raised a number of objections but we thought it was rather a nice one was to try and get over the rate rebate scheme to a large extent by making it self-adjusting and to give everybody a credit, so to speak, against their rates but make that credit taxable, and I see here that you envisage that this would make something like 200,000 people taxable who are not at present, and so this would be a considerable complication from your point of view. We were wondering whether this was possibly a slight over-estimate in a way in that some of these 200,000 might come in anyway. Do you agree that that is so, or have you allowed for that?

-A: They may do; of course it is an annual complaint of the Opposition, of whatever complexion, that when the Chancellor increases the personal annual allowance with the professed objective of taking people out of tax they will come in again by the end of the year. This is perfectly true. It depends on the rate of inflation, but there is that risk. May I just add a point to this that has occurred to me on reading these papers myself. There is a complication in this mechanism, is there not, which one would have to provide for, for the inclusive rent-payer. You see, one must recognise who the ratepayers are in order to give relief, and if, as I think is quite customary with council house rents, a man was paying a rent which was inclusive of rates, one would have to recognise that chap in order to give him a credit.

Q: It is a problem of identification.

-A: Yes.

Q: You are suggesting as an alternative a sort of short cut, are you not, in your paper, that one gives a fixed allow-

ance against the rate claim and the rating authority can collect the money from central government, so to speak?

-A: Yes.

Q: This would not have the same variation and effect on the ratepayer as the scheme we had in mind.

-A: No, the distribution effect would be different.

-A: With respect, is that necessarily so, if you reduced his rate bill by the amount of tax relief which he would have received? If you give the ratepayer a deduction from his rate bill equal to tax at the basic rate on that rate bill, subject to certain over-riding limits as you have suggested, would that not have roughly the same effect, without interfering with his tax liability. Instead of reducing his tax liability by that amount you reduce his rate liability by that amount. I would have thought we were getting to the same objective by a different route.

Q: The rating authority would then top up and collect it, yes. Quite an attractive proposition.

-A: You may be interested, in this sort of approach, in looking at the Green Paper which we put out on tax credits, because we suggested there that if we did have a tax credit scheme we would apply that sort of technique to life assurance premiums and also to building society interest, to get away from the present complications, and it may be that that will give a lead. Perhaps I ought to add to that that as far as we are concerned this would be a great saving and we are now striving to persuade Ministers that notwithstanding the shelving of the tax credit scheme that these two elements of it at least should be introduced, and just for a change we can say that that will save us about 4,000 staff, which might be employed elsewhere.

Q: The only point at issue here, is that we do at present have the domestic element of the rate support grant which in effect is doing what the Inland Revenue are claiming can be done quite

simply, namely it simply gives a straight relief to the domestic ratepayer, and the government compensates the local authorities for that. The criticism which one has of the existing domestic element is that expressed as it is in terms of so many pence in the pound on rateable value it actually gives most help in general to those with the highest incomes, and in looking at this tax ploy that my colleague just mentioned one is really looking at ways in which the domestic relief, which is now amounting to about £600 million in total, could be distributed in a way which would give more help to people on low incomes and might thereby reduce the need for a rate rebate scheme. From that point of view therefore the idea of a basic rate allowance which would benefit people on low incomes and who were paying small amounts of tax has quite a lot to commend it. This was the reason why we were wanting to explore that particular avenue rather than an adjustment of the thing itself.

-A: It would help people on medium low incomes. It would not help people on low incomes, because they would not be paying tax. The married man with six children who is not in tax at all, you do not help him by giving him tax relief.

Q: Sorry, I was talking about the second proposition.

-A: I am so sorry.

Q: The chap that you were talking about; he would get the whole of the allowance.

-A: Yes, on your scheme. I misunderstood.

Q: I do see, you say that the problems of identification, of marrying the ratepayer and the tax system, would be heightened because you would be seeking recipients of taxable income. Could that be got over by the proposition you talked of earlier, of local authorities notifying tax offices, like building societies?

-A: Yes, I think so.

-A: With the building society case, the

initiative is with the taxpayer, the man who has got the mortgage, who is in contact with his tax office. He writes to the tax office via the building society and says: "I have a mortgage with the" - whatever it is - "building society" and then there is a link established between the tax office and the building society. So it is not the building society in the first place which says: "This chap has got a mortgage with us." So I would think with your suggestion one would want the ratepayer to get in touch with his tax office and say, "I pay this amount of rates", or "I pay rates and this local authority will tell you what I pay."

(Note by witness: Most building societies operate an arrangement under which they send a copy of a special tax form to a person who takes out a mortgage. This form asks for the mortgagor's tax reference number, place of employment, etc; and he is asked to send it to the building society after completion. The society then insert particulars of interest etc. and pass it on to the appropriate tax district.)

Q: I was thinking if you were one of these three year tax return chaps and you have just entered into a mortgage having just completed your last return, have you got to wait three years before anything comes through?

-A: I am sorry?

Q: You are a new mortgagor but you have just completed your tax return; have you got to wait another three years before you get another tax return?

-A: He will normally write to the tax office and say, "I've just taken out a mortgage; I want some tax relief."

Q: Presumably he would write to the local authority or write to the tax office.

-A: Saying, "I am a ratepayer".

Q: On the Freudian principle that envelopes containing cheques are less easily lost than those containing bills! Now may we turn to Schedule A.

Q: Could I start by apologising here. I think those of us who were interested in this question have misled you somewhat and partly misled our own secretariat, and so about half your paper is very relevant to our concern and some of it is not. So please accept my apologies.

-**A:** Which half?

Q: It is the first half which is the more interesting in relation to our concern. For one or two reasons—and I will tell you what I think is the main one—we were interested to get a rather superficial view as to how difficult it would be to reintroduce Schedule A as a national tax. The main reason to my mind—though there are one or two other contexts in which for optical and other reasons it might make some sense—is that it has been borne in on us among other things that if the domestic rate were abolished it must not be assumed that if one proposed, for instance, that we replace it by a local income tax that that local income tax would be strictly additional to the existing income tax. The Chancellor of the Exchequer in his discretion might want to make adjustments all over the place and this is possibly one of the adjustments he might want to make. That has been suggested to us. Something which I think strikes us all forcibly is the fact that rates is a very, very important aspect in the whole of what might be described as a fiscal package surrounding housing, and one might take the view that one should not do anything very drastic about the rates except in the context of doing something very drastic about the whole pattern of subsidy etc., which surrounds housing. It is in this sort of context that we ask, not that we intend to make precise recommendations in this field but we would just like to have a sense of what possible options are open. We were, therefore, wondering whether there are insuperable difficulties in the face of reintroducing Schedule A as a tax on owner-occupiers in broadly the same form that it existed before. Now, having explained why we posed the ques-

tion, and looking at your paper, I think the first question that hits one is this: if valuations had been kept up to date was there in the last resort any insuperable problem about continuing? It seems to me partly administrative and partly a valuation problem.

-**A:** Yes, what I think on re-reading this paper does not come out quite as clearly as it came out to us in 1962 is the way in which Schedule A had more or less been nullified by the enormous growth in the cost of repairs. You would be very pleased now to pay the cost of repairs that one paid in 1962, but in 1962 anyway it seemed to us that they had grown a lot. We had what we called maintenance claims made by the owner for the maintenance of his house which, provided the expenditure exceeded the statutory amount for repairs, could be set against Schedule A. Because the valuation was not going up, because the cost of repairs was going up, we had a growing number of these claims which not only created work but wiped out Schedule A. So to go back to what you said, provided we were able to keep the valuation at some rational basis even with maintenance claims it would have been perfectly feasible for us to have gone on with it. I think the reason why Schedule A went was not an administrative reason at all but the philosophical argument which appealed to the Government of the day that it was wrong to tax notional income, that it was wrong to tax the annual value of a house but not the annual value of a refrigerator.

Q: In a sense one would be up against a similar valuation problem to the one which is arising now in the rating field, that because of the demise of the private rented sector in any sensible sense market rents for analogous houses would not be ascertainable, so that one would be rather driven to assume that if one re-introduced Schedule A one might have to go towards capital valuation, translating it by dividing by the right number into an annual taxable income.

-**A:** Yes.

Q: I am sorry, I am leading you in. I assume this is right. It is essentially the same problem as one faces in the rating field?

-A: Yes, this is entirely right. I think if I remember rightly—and my colleagues will correct me if I do not—that so long as Schedule A ran the values were in practise derived from the rating valuations. The deductions were on a different statutory basis so although the gross assessments may have been the same, the nets finished up differently. In law, however, there was no necessary correlation between the two. There was *Walker v Brisley*, do I remember?

-A: Yes, I think historically it was that in 1935/6 rating was done by the local authorities and Schedule A was done by us, and 1935/6 just went on from year to year as the basis for Schedule A.

-A: In this particular case a man claimed that his tax value should be the same as the rating, and the Courts dismissed this, but in fact it was in many cases the same.

Q: If the rates were retained and there was a move to capital valuation, you would then have a valuation system which you could fairly readily use for the purpose of Schedule A if somebody wanted to reintroduce it.

-A: Yes, you would have figures to use.

Q: I must confess that on the argument about refrigerators, while one can see its logic, it is not a frightfully compelling one. You say this was essentially the main argument at the time?

-A: Yes, I do not know if you were able to look at the paragraphs we enclosed of the Royal Commissions's Report. They did not think much of this argument.

Q: The Parliamentary point was strongly made at the time, and widely thought to be right at the time, that if everybody diligently looked at their maintenance costs it would pretty well nullify Schedule A.

Q: With the wrong valuations.

Q: Yes, at that time.

-A: I think no government dared put the valuations up.

Q: Does the argument about notional income apply equally to the rates and to the rating system?

-A: Well, it does for the owner-occupier, does it not? Well, yes, it does, it is a form of notional income.

Q: It is a form of imputed expenditure.

-A: I am sorry if we have wasted the Committee's time by the second bit.

Q: No, no, we wasted your time.

-A: It might help if I explained what we thought your thinking was. What you said to yourselves was we assumed that the total income as a base from local taxation could be questioned but one might look at the value of the house and apply to it, as it were, some tax rate related to the national income. One has got two elements in any charge; one has got a base and one has got a rate at which that base is charged. If you narrowed the base then you have more liberty to charge a different rate.

Q: What you are saying is analogous to one other point which was in the mind of one or two people. If one moved to capital values for rating there is something rather optically difficult about charging tenants on a rating system that is based on capital values and to that extent your work is not irrelevant.

Could I briefly just raise one other question of a different nature. It is of course widely alleged that rates are not buoyant enough. Let us not pause over what buoyant means. It is also widely complained that income tax is too buoyant because the allowances and steps in the scale are not indexed in any way to inflation, the tax is too buoyant, and there is an undue element of fiscal drag which allows Chancellors to reduce people's real incomes by taxation without decisions being taken that this should happen, by anybody other than the executive. It is perhaps arguable

that there is perhaps an even stronger case against a local tax being too buoyant in this way. Therefore the question is quite simply this: quite apart from the merits of indexation and the possible resistance of politicians at the centre, do you see – and you must have studied this – any serious practical problems in indexing the allowances and indexing the steps in the scale?

–A: I was summoned as a witness three weeks ago to the Select Committee on Public Expenditure when Mr Nigel Lawson asked me precisely that question and I said, "No technical difficulty at all." There is a difficulty for the Chancellor of course but not one for us. I ought to add perhaps to that that when I answered that I was thinking mainly in terms of the two main allowances, the single and married person's allowance. Naturally, if you are altering all the other allowances there is a lot of work involved in tax offices in altering code numbers. That would be a nuisance and that would be a technical problem, but simply indexing the higher and the lower personal allowance, that is no different from what is happening at the moment and that is a sort of *ad hoc* addition to each of those each year; one is only altering the amount.

–A: If you indexed the higher rate thresholds and the various bands that again would be slightly more difficult; you would need new tax tables.

–A: It is more difficult in the short term but less in the long, because we are worried about the number of people who are moving up because of fiscal drag into the higher rates. This is growing alarmingly from our administrative point of view.

Q: What are the problems for the Chancellor?

–A: If you have a system of indexation you reduce his capacity to take advantage of fiscal drag. You put some limits on his freedom – to some extent on what his budget strategy should be.

Q: And precisely what people complain of.

Q: He wants a situation which is the opposite to the local authorities' where you have to show your accountability by taking a step.

Q: So any increase in tax would be a blatant increase in tax and one could see exactly what this real increase was.

–A: Yes. I mean, that may well be a disadvantage to the Chancellor. It is an interesting fact incidentally for one to recall the present Lord Barber's quite large increases in the personal allowances and the presumptive reduction in the tax gathered. Actually, the income tax that year was higher than the year before.

Q: Again without getting into the question of buoyancy there is obviously a case in which for a national matter of economics in inflation times, the Chancellor would need a too buoyant income tax, whereas for a LIT which is intended to have some relationship to public expenditure the characteristic would be wrong?

–A: Yes.

Q: If we do not have indexation, can you see any insuperable difficulty in using the mathematical formula for distributing LIT having discontinuity on the lines suggested by Mr McIntosh, on the assumption of a buoyant rate, not a too buoyant rate?

–A: If one was distributing on the basis of "income times the locally determined rate", then one would presumably apply some sort of reducing factor to the income.

Q: That would be a possibility to get over the question of a too buoyant feeling of public expenditure at local level?

–A: Yes, although with the £6 a week maximum one is facing one does not expect buoyancy to the same degree as we have had.

Q: I am not sure whether this question is covered in other ways. I rather think it is, but perhaps I had better just raise it. One of the possibilities that has been canvassed before us is quite regardless of whether you raise your rates

through a local income tax, that grants ought to be based upon the taxable capacity in the income tax sense of the local authority area. When we are looking at your estimates of work given for an appropriate number of years, say, three or four, how difficult would it be, if one were merely on a broad basis, not in the context of grant particularly, too finely divided, how easy would it be or how difficult would it be to provide the information as to the total taxable level of each authority?

-A: I think one would do this on a sampling basis and look at every hundred cases, five hundred cases, whatever was statistically viable, and calculate it fairly quickly. There would be some work in it but not such as I think would cause us great worry, not of the sort of dimensions as are mentioned here.

Q: And assuming that it was designed to do that and not seriously disrupt many other tasks you have in hand, what sort of time scale would a satisfactory exercise of that kind involve, from the time that the Government decided that it wished you to do it?

-A: I should think it would be comfortably done within a year.

-A: Yes.

-A: And possibly less. I would like to enquire about this when I get back, but certainly 12 months or less, I think I can say quite certainly, now.

Q: A quite important variant is that this would not involve raising income tax on that basis.

-A: There is a sort of parallel here. You may know that we charge building societies on what is called a composite rate as part of their tax liability. In order to arrive at that rate we do an exercise in which we test what the tax liability is of a percentage of mortgagees, and this is a thing that we do automatically each year. This other project would be similar.

Q: On the question of computerisation, you have a computer at East Kilbride which had a whole lot of teeth-

ing difficulties but is doing a good job now, and of course it is buttressed by the local inquiry offices throughout Scotland. Is it the idea to extend this to the rest of the United Kingdom?

-A: Not in precisely that form. We started out with East Kilbride on the basis that we were going to have eight other computers with much the same sort of organisation, that is to say, all clerical back-up situated in buildings hard by the computer itself. For reasons which I do not need to go into here, our computerisation has been put off by various governments having good ideas as to what they wanted to do with the tax system, and we have only now got down to considering in detail how we shall go on. What we have in mind now is to have a smaller number of computers dealing with tax districts which are in something like the present area pattern and of about the same size as the one which you saw when you went to Liverpool, 250-300 staff, each computer serving a number of these over land lines or some such convenience as that. We are planning for the first of these fairly soon but as you know with all computer operations one is talking in terms of years, almost decades.

Q: So it is a large amount of small computers?

-A: We are not sure whether we are going for one or two national ones, or a large number. I think we will probably have fewer, one or two computers rather than many. The clerks in tax offices will be using visual display units in order to communicate with the computer.

Q: I am not quite sure what are the determinants in this exercise. I suppose there are two possible positions and could I just explore them. Either you may be in a position of saying, "Well, there is not going to be the money and the materials forthcoming soon so we won't hasten particularly towards deciding it until such time as it is clear that there are resources available", or the limiting factor could be that there are internal difficulties in deciding what is

the best pattern for some reason or other. I am not sure what is holding things up.

-A: Just the time it takes to get a computer. We are pushing on as hard as we can. I am sorry to keep extending your reading matter, but you might find one of the appendices in the report of the Estimates Committee 1968/9 on the Inland Revenue useful. We gave them a paper on our computer experience thus far. Round about that time it came to a grinding halt because the Conservative Government wanted us to explore an entirely different form of Pay-As-You-Earn which was on a non-cumulative basis, and therefore we just had to put a stop to all the ideas of putting cumulative PAYE on to a computer. Having done that, we were then overtaken by the tax credit scheme which implied an entirely different sort of organisation, and entirely different material to put on the computer. Once again we could not push on with our plans, and it was only when the tax credit scheme was put on the shelf, almost on the day the Labour Government announced this, that we set up our ADP team again and they are now busy producing various plans. Once we get a fair wind and absence of obstruction on this, we will push on, and I think neither of the two things that you suggested will hold us up.

Q: I am still not quite clear about that. Is it that there are computers on order and you simply cannot get them delivered in time or is it that you have not yet decided what computers you want?

-A: We are not yet to the point of ordering them. We are getting the basic plans. It is not really a problem. Governments are rather different from private industry. Private industry tended in the past—I do not know if it still does—to go out and buy a computer and then say, "What shall we do with it?" In government quite properly one has to have a very detailed and thorough examination before one is allowed to place any order. It is that detailed and thorough examination that is going on.

Q: Then it is the formulation of what are your needs that is the determining limiting factor at the moment?

-A: At the moment, yes. The difficulty with East Kilbride was very largely the physical act of putting up the building. If you do go there you will find it is a 16-storey building with the computer at the bottom with 1,200 clerical officers sitting on 16 floors above it. That concept has been abandoned, so that the building problem will be less. You might only want a single or double storey building. The lead time of four or five years, has been 12 in Bootle. We put up a large building in Bootle to take the second of our computers but because of strikes and difficulties there I think it has been 12 years building, and not yet finished.

Q: Yes, we were there.

-A: Yes, you were there of course. But that problem ought not to affect us with our future plans.

Q: If the programme now goes as you might expect, when would you expect to get the first of the new sequence of computers in operation?

-A: I know that that is on a piece of paper that I have got in the office somewhere. I do not carry it in my head, but could I write to you?

Q: Yes. May I ask you so that I have got this quite clear: what is currently broadly envisaged is a computer that will serve, six, seven, eight districts?

-A: Yes.

Q: And linked to all the offices concerned. And how many would that require for the whole country, if you had six, seven or eight?

-A: We were thinking in terms of two or three at the most.

Q: Two or three for the whole country?

-A: Yes. In the Republic of Ireland where they have in fact done this, they have got one computer, a smaller unit of course, which is quite splendid in its effects. It sends out assessment notices

which combine not only income tax under various schedules but also VAT, and a person gets one bill for all the tax. We cannot achieve that in Britain but it is a splendid scheme and we envy it.

Could I just say to avoid any confusion that might arise, that we have got ideas for two series of computers; one series where we are fairly well advanced and the first of three centres will be opened next year or 1977 will be responsible for doing two main things. It will print assessments and stimulate action for Schedule D, that is the self-employed tax. This particular one will cover all the north of England and Scotland, and two others will take over the rest of the country. That series of computers will also do collecting and people will be expected to send cheques to the centre in response to demands which start from there. If the taxpayer pays promptly then that is the end of his business with the Revenue. If he does not pay then there will be a number of local recovery offices who will call on him and stimulate him to action. That is one series of computers. The other series of computers will do what you saw in Bootle, PAYE assessing and coding.

Q: If the government say in 18 months' time they are determined upon some form of local income tax, would

that necessarily delay the computer programme or merely alter it or neither?

-A: I think we would have to consider first what form it would take. It may delay things slightly, but I do not think I could give an informed answer to that without talking to our experts about this. It is their territory. I once felt at home on it but that is twenty years ago and things have marched on. If it would be helpful we could give you an assessment.

Q: I think a general indication would be helpful. It would be a factor to be borne in mind if once again it is going seriously to impede the shift to computers in a whole variety of degree. If it is merely going to alter the programme, that is a different question. Perhaps we could use as a guide the McIntosh model as a test.

-A: Yes, the thing that is in my mind is what sort of extra capacity might be necessary for storing addresses.

Q: Once again, thank you very much for helping us. It has been a most interesting and illuminating morning and a most dangerous morning in some senses because one or two laymen like myself may be able to get the sense of the thing and know what it is about! But it has been very valuable. Thank you very much.

Oral Evidence by the Inland Revenue

THIRD SESSION - 13 OCTOBER 1975

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ORAL EVIDENCE—INLAND REVENUE

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Sir Norman Price (Chairman of the Board)

Mr J H Gracey (Under Secretary to the Board)

Mr B J Thomas (Assistant Secretary)

Note taken by CSD Reporter

Q: Sir Norman, offering thanks to you and your colleagues for finding time to come here almost has become a way of life to us, but I hope you will not think that it any less indicates our appreciation. We do understand what great demands there are on your time and we appreciate your willingness to give us time at short notice. May I interpolate at that point that you very kindly let us have a document today which we have glanced at but not yet read. Thank you for letting us have it, and we will return to that when we have had time to think about it. We had not, unless you had a special reason, intended to deal with that centrally today, unless some point came up.

As you know at our request your colleagues very kindly came to a meeting here on 2 October, and during that meeting we entertained some anxieties about quite where we had got to. It seemed to us, certainly from our point of view, rather important not to leave the matter there unless we were quite clear where the work now stood. As a result of that, as you know, Mr McIntosh wrote to Mr Gracey on 7 October

and set out the general framework of what we would like to have the chance to discuss with you this afternoon.

-A: Yes.

Q: As before I am going to ask my colleague to deal with the most central questions. When one or other of us does not quite understand a point the two of you have reached we may intervene. I will ask him now to start the questions we would like to raise with you.

-A: Thank you very much.

Q: On 2 October you told one or two of the members that basically you have come to two conclusions. The first was that it was not practicable to run a local income tax piggyback, if I may use a metaphor, on the present PAYE system. Therefore, and consequently, a local income tax would require a major recasting of the method of collection of our income tax system, perhaps in the direction of, for instance, a non-cumulative PAYE. I think it is quite wrong to say it was a total surprise to us, but it came as a rather emphatic statement after a series of exchanges

in which we tried to see what was the cheapest way of doing it piggyback without necessarily saying it was a good thing, but saying, "Can it be done in this sort of way?" It is in that framework, against that background, that the Chairman is most anxious that the whole committee should have the chance of talking to you again. I think we have written a letter which Peter McIntosh signed addressed to John Gracey where there are four broad questions, and I would like, if I may, to take what I regard as the narrowest of them, namely the third one, which is, has there been any subsequent work which has caused you to reconsider your earlier position? Have you done some exercise which has caused you to come to this conclusion, or have you arrived at it by other means?

-A: I think the answer to that is no, we have not done any extra work. What my colleague said – and he said it after coming and having a discussion with me knowing the question might well be put – was very much what we have been thinking all along. I think we can trace in evidence that we gave you earlier indications that we have always thought that the piggyback approach, as you aptly express it, was never really workable. I very much hope that we have not misled you in our discussions. What we have tried to do when Mr McIntosh with dexterity and nimbleness of mind, for which I compliment him, has put up various specific ideas is to say, "Well, this particular problem could be solved this way; and that problem you might deal with in some other way". But we have always had at the back of our mind – and I think, with respect, you had not really asked us the question before – that when you add all those together the whole thing is in our terms not workable.

So we are merely reiterating what we have said. Our impression of the workability of this, the viability of it, is that it really is too much. It is rather like, if I may say so, what I think was the philosophy of holism propogated by General Smuts, that one can have lots of parts and deal with them, but

when you have got a whole it is really greater than the sum of those parts.

I think our worry is this – and this leads from the first of your two points into the second – that the weight of work, the changes in the income tax structure, which already have to be borne in the tax offices and in employers' offices are straining their mental resources to the uttermost. One cannot say with any degree of confidence whatsoever that adding something else, and something else quite considerable, to what is already there will really be workable. That is why, to go on to the second point, my colleague suggested that the only way in which we could think of local income tax in the terms which you have put to us was by a pruning of the existing system. The addition then would not be too much for both tax offices and employers to bear. If one had a simpler system with which to start one could build on it. With a complicated system the extra rooms on top are really too much, the whole thing becomes top-heavy and might well capsize. That is our worry. I have not got, I am afraid, any evidence on that. It is simply the feeling. You will remember what Whistler said in the civil case against Ruskin – "you are asking me for the experience of a lifetime". That is all I can give you. But for what it is worth that is our view, that really this addition would be too much.

Q: I hope I can speak for my colleagues when I say that it is no part of our preoccupation to go over the history of our exchanges in the last few months in order to identify what happened, but I am sure you will take as a fact that whereas your original document made it clear to say the least of it, that you thought this was a pretty difficult and probably impracticable exercise, you did not say so in as many words. I think it is true as a matter of fact – and I ask you to accept this – that possibly we began to get the impression that you thought the thing was workable as a piggyback, if at very large cost. Can we dismiss the question

of history? What we really want to get down to now is the turkey and to stick strictly to this question of the reasons which brought you to this. Some of them are evident and I like your quotation, you have to some extent anticipated my question. Nevertheless, my question remains; what is the straw which breaks the camel's back? This is something we find it hard to put our finger on. I think some of us at least see it impressionistically, some of us have visited revenue offices, and some of us have this feeling that the thing taken together is very difficult. It was I myself who said on an earlier occasion your paper amounted to saying that if you wanted a local income tax you would not start from here.

-A: Yes.

Q: But nevertheless if there is anything you can say which would help us? Your quotation is a persuasive remark and if you can tell us what it is that is absolutely the essence, what would you regard as the essence of the difficulty?

-A: If I can start further back I think the suggestions which Mr McIntosh has made, two in particular, could be said to have eased the original problem a great deal. Those two, were first the residence question, where the suggestion was made that we fix the residence for a time, a period, before the tax year began; that eased the worries we had that the pure local income tax system would be related to the residence for the time being. The other suggestion was the dissociation of the moneys which we received from the employer from the moneys which we passed to local authorities, and instead we pass moneys to local authorities on the basis of splitting up the total pool that we had received in some agreed measured proportion. I think those two things did make some easement of the situation as we had conceived it.

Our worry is I think again in totality. First one is going to ask tax districts to acquire another large piece of information and that is, where was the man living at such-and-such a date? We

have to incorporate that piece of information in a document that is sent out both to the tax-payer and to the employer. The difficulty for the employer is in handling deductions of tax at a large number of different rates. Then, coming back to us again, there is the investment income side. Now once again the committee suggested that this problem might be solved by a common deduction, a standard deduction from dividends which would then be the final figure for the liability to local income tax of receivers of dividends, interest and so on. That particular problem we do not think will be solved by that road. Our experience would be, we would have to tell you, that whether that particular rate was pitched as a median figure or the highest figure – and we will go into why either of those afterwards – whether the common rate was pitched at one or the other, one would raise such a storm of protest that it is very unlikely that a government of any complexion would be able to hold to that particular line. The result would then be I think that one would be obliged somehow or another to work out an exact rate of tax, exact, that is, in terms of the rate of the particular local authority, an exact rate of tax for each receiver of a dividend or interest. If there is any single item which would be the straw to break the camel's back it is the necessity for assessing all items of investment income of that kind. I am not implying, by saying that, that that is the only straw. I am merely picking that out as being an extreme example of the difficulty. But it is the combination of all these factors, both in tax offices and on the employer, which we feel on the basis of our terribly complicated system that we have now would make people throw up their hands in horror.

Q: May I say that it was the intention that I should ask the third question first and the fourth question second. Now may I try a sort of "late burst". A great deal of this thing, and I am not decrying what you are saying at all, depends, as you have said, upon the totality of the effects of a lot of things,

and that is why you hesitate to pick out the final straw.

-A: Yes.

Q: Would it be useful to turn it round this way? If you took, say, Sweden, take if you like the United States, some other country where they have a local income tax system where you do not start obviously with a cumulative PAYE as you have here; you are saying the cumulative PAYE as it stands throws a variety of tasks, which could in fact be itemised, on tax offices and on employers. The superimposition of a local income tax imposes a further collection of tasks.

-A: Yes.

Q: Would it be helpful if you, or one of your colleagues, could give us an indication of some of the things which do not have to be done in Sweden in the context of non-cumulative PAYE which do have to be done here? I am trying to get to the straws again. They have less straws on their camel's back. What are the straws they have not got?

-A: May I start, and then my colleagues perhaps can add the things which I am sure I shall miss, but apologising first that the form of my answer has made you alter the order of the questions.

Q: No, no, it is not at all pre-determined!

-A: I think there are two main themes here. First of all there is the complication of our personal allowance system in this country. We have not only the allowance for the married and single person, but also the child allowance, dependent relative relief, housekeeper allowance, blind allowance, life assurance relief and mortgage interest. All these tax reliefs are at present given through the PAYE code number. In any one of those instances one might have a change during the year, a new child, a change in the mortgage, a new life assurance policy, and the event would give rise to a change in the code number. I do not think any other country has the large number of allow-

ances that we have. Therefore, during the course of a tax year they are much less liable to have to change the allowance than we are here. The alterations of coding numbers do impose a very heavy task on tax offices. They mean that when the employer receives notification that the code has changed he has got to alter his records, and they may be on a computer, they may not, but some change has taken place, and a large employer must get a large number of alterations of this kind all the time. That is the first thing I think where we tend to differ from other countries, and where a cumulative system which, as you know, tries to keep pace with these changes is at a disadvantage in administrative terms as compared with a non-cumulative one.

The other big difference between our present system and that of every other country is in the change of job sphere. There are something like ten million changes of job each year, and if the machinery works well these should not give rise to any difficulty. The system ought to be that each employee when he changes his job is given a P45 and he disposes of the various bits of that P45 in a way which should ensure that his own tax deductions are continued at the proper rate, that the tax office of his old employment and the tax office of his new employment are both notified of the change, and the files can be moved. In fact the employers are not always terribly good at giving the P45s because they are human, the employees are not very good at doing their bit, and in a large number of cases—and that has to be reckoned in millions—this chain, which on paper is a perfect one, breaks. It gives rise to trouble which the tax offices have to meet by trying to mend the chain. In some jobs, like waiters or the building employee when he is not on the lump, the changes of job are so frequent that a break in the chain can be very difficult to mend indeed, because the waiter, the building employee, is on to his third or his fourth employer before one has caught up with his first move. This imposes a very difficult task on tax offices, because the

cumulative system exists. Other countries do not have this because they merely wait until the end of the year and sort out the thing and correct it then. If one could get rid of this by going to a non-cumulative system, and there are disadvantages about that, I would think one is able to take into account additions to the general workload.

Q: Can we just try and identify quite what it is that, say, the Swedish tax office or employer does not have to do?

-*A:* Yes.

Q: Are you saying not only have they got less personal allowances but if there is a change in a person's circumstances affecting his allowance this to all intents and purposes is left until the end of the year with the assessment operation?

-*A:* Yes.

Q: That is the first area. Now on the change of job point it is not entirely clear to me what it is that the Swede does not have to do.

-*A:* He does not have to have a chain. He merely waits to see what has happened at the end of the year.

Q: I see.

-*A:* And then they can make an assessment. Can I turn to my colleague here because we were so startled by what you told us on an earlier occasion about the Swedes accepting a rate of 66 per cent that we despatched him to find out why.

-*A:* I think this ties in with the way that residence is built into the Swedish tax system. With the sort of piggyback scheme that you were postulating one would have the pay-as-you-earn system going on in something like its present form, but with the additional job of feeding in where the chap lives and making all the necessary adjustments. In Sweden, as I understand it, you have to decide where the man lives before the system begins at all. The foundation of the whole system is the local register, and everything is based on that. As my colleague was saying, nothing has to be done during the year. If a man changes

his job he just collects a form I think from his first employer and gives it to his second, but the tax office has no function, and it is not until the end of the year when he fills in on his tax return his income from his various occupations and sends that in to his local tax office that the serious tax office operation really begins. There is not the problem of keeping up to date as the year passes by, keeping accurate the level of tax deductions. You have residence built in and you have a year end assessment.

Q: I would like to ask an obvious point, and I am sure it ought to be quite clear to me, but it is not particularly, although you very kindly let us see this operating. I understand, and I think those of my colleagues who came with me on the visit which you arranged for us do, one sees in reality the workload you are describing. What I find difficult to get a clear picture of in my mind is, given the difficulties with the two main streams which you have described, those relating to variation of allowances and their application on the one hand, and job structure on the other, given that, and given that we talk for convenience about the McIntosh model as a vehicle for thought in this connection, the bit that is missing in my mind is why should the work that is involved in that make this particular pair of difficulties so much worse? I see the point, and it is when it comes to trying to measure what is involved I find I am not carried the whole way in understanding.

-*A:* As far as the tax office is concerned I think it is the extra task of another universal element that has got to be taken into account in the code. This may only be a question of adding some sort of indication at the end of the code number, that it is a 3p rate, or 6p rate, or whatever, however one does that, but there are 25 million chances of getting that wrong, of making whatever it is that we are doing intelligible to the recipient of the indication. That in itself is a pretty formidable task I think, even if we say that the scheme can be devised so that there can be no change

of rate within the year. That is the first thing I think. The second is the very major task on the shoulders of the employer, which is that having received these code numbers in respect of these various employees he would be applying a different set of tax rates to each of his employees as they came along. I do not think there is any way of avoiding this, that the first man coming along will be having a code which indicates that it is 3p, the next man that it is 6p, the next man that it is 5p, the next man that it is 3p again. Presumably if the employer had a computer – and I agree that a large number of them have – providing he could accommodate this within his programme without buying another computer this would not present a lot of difficulty, but in numbers the great majority of employers have not got computers. Maybe the number of employees dealt with on a computer is higher than those that are not, but the number of employers who do not use a computer vastly exceeds those that do, and it is the extra difficulty that is caused to those, the risk of a breakdown there, in addition to all their VAT problems, and all the things they do with us. That is where I think we are mainly worried.

Q: Can I see if I have followed it correctly? You are saying there that the generation of the mistake, the source of anxiety, is at the employer's end and not at your offices's end?

-A: That second worry would certainly be with the employers, yes.

Q: Can I take this point a little further just on this particular line of thought? The effect of disturbance in almost any organisation depends to some extent on how rapidly you bring it in, how well you tell people, how long you give them to think about it, whether you do it in one stage or more than one stage.

-A: Yes.

Q: If we talk, as I take it we are, on any hypothetical basis that it would probably be five years before the word

go is given for the simplest system, would the long period of run-up, the capability of explaining it, plus the possibility of not taking it all in one lot, go any useful way to ameliorating the problem?

-A: Of course it would help enormously, but at the end of the day one has to deal with, I am afraid, a large number of people, small shopkeepers, farmers, who would be in the net and tend not to read any literature until they have actually got to do something, and perhaps not even then. Although one would reach a large number of employers and ease the problem to some extent, there would still be in numbers a very large group like this where personal tuition is the only possible way.

Q: I can quite see that. Is it possible to foresee a situation in which the actual address itself carried the code so that once you registered the address in a sense you could not go wrong?

-A: Of course in the normal way the employer would not know from us the address of the employee; you have to build that in. He may know from other particulars he has, but not from us.

Q: He will at some stage under any system on this model have to know the address, and the address would have to be either on the P45 or some other document.

-A: He need not know the address, if I may say so. All he needs is the rate at which the particular local authority charges. If three local authorities in a neighbourhood charge the same figure, all the employer would know is a local authority charge, and the employee might live in any of those three areas.

Q: In quite a number of systems, not as far as I know tax systems, the address is a self-coding device in itself, the place, the town or the county is itself a code, and anybody dealing with the document does not have to know anything about it, but it self-codes itself. But that is an aside.

-A: I would hesitate to put this task on the backs of all our million employers.

May I make a suggestion? I do not know whether you have seen the employers' representatives, either the CBI or the ABCC, you may have seen them in another context. I accept that we are trying to voice doubts which I think they would tell you, but it may be that they have got different views altogether, and if it were possible within your time limit to talk to the taxation committee of both those bodies it could be that they may say something different from us. I do not know. All I can record is that when we put the tax credit scheme out for public discussion there were aspects there to which they reacted very, very strongly indeed. We had to change as a result.

Q: Can we in fact move now into that kind of area, the area of tax credit schemes, non-cumulative systems, and so on.

-A: Yes.

Q: Perhaps it might be useful as a time scale has just been mentioned — my colleague used five years as an illustrative period for doing a piggyback scheme — I would not like to pin you down to any exact point, but we got the impression that the introduction of a non-cumulative system of PAYE, on whatever grounds it was designed, the presumption is that with a non-cumulative system you could have the local income tax.

-A: Yes.

Q: As I recall it — correct me if I am wrong — a tax credit scheme was envisaged as coming into effect about five to six years from the point of publication of the original document.

-A: Yes.

Q: That was in a sense a system on which it would have been much easier to superimpose something.

-A: Certainly.

Q: Is there any reason for thinking that such a system would take longer now than it was thought that it would take at the time?

-A: No, I do not think so. The time span there was for programming and getting a computer into operation. It is about the same time. Could I, however, just make a distinction in what you said? I think one ought to make a clear distinction between on the one hand a non-cumulative system, and on the other a system like tax credit. A system like tax credit could be cumulative, but the virtue about it is that because it only gives a very small range of allowances — the dependent relative relief would have gone, the housekeeper relief would have gone, the complication of mortgage interest and of life assurance would have gone — it is the disappearance of the allowances rather than any question of cumulation which gives the opportunity under a tax credit scheme to build something up on top because it is simplified.

Q: One provides a working leeway and the other provides a different basis.

-A: Yes, that is right.

Q: The tax credit scheme as conceived was nevertheless basically non-cumulative, was it not?

-A: Basically non-cumulative, but I could conceive of a system which did not have the particular attributes of the tax credit scheme — i.e. taking tax on all income and paying a credit — which was a simplified scheme but introduced a lot of the benefits of the tax credit scheme. It would still be like an income tax scheme but with a pruning of the allowances.

Q: You were saying that the time would be the same. Can we be quite clear what the time is?

-A: It is four or five years, that sort of time.

Q: This illuminates the earlier discussion in a way.

-A: Yes.

Q: Because in effect what you are saying now is that if you can remove a major load from the work period, e.g. by reducing it from however many

umpteen allowances to two—if you can get it down to two or three that in itself would create, as it were, the capacity, and the capacity here I think is used in a mixed sense, it is partly numbers of people, but partly it is what the people of the standard you are employing can be expected to cope with.

-A: This is exactly right, and at the risk of boring the committee may I just spell out what some of the possibilities are here? First of all it has already been announced that the present Government want to go over to a system of enhanced family allowances, family allowances paid to everybody, and they will be big enough to take account of child tax allowances. That would be outside the tax system. We think also that by adopting the scheme which we proposed as an incidental to the tax credit scheme of deducting tax from payments of interest to building societies, one could greatly simplify PAYE by that and save some staff.

Thirdly, by adapting the system of giving relief for life assurance premiums so that they too were treated as if paid under deduction of tax at source with the balance made up by a payment from central government to the life offices, that would be a further element in simplification.

One is then left with the complicated allowances like dependent relative relief, which is daily losing its importance in the tax field, with the housekeeper allowance which the Royal Commission of 1955 advised against anyway, and one or two things of that kind. Take those out of the tax system by one means or another and then we can begin to think. So long as they are still within the tax system we would still say it is too complicated to take a superstructure.

Q: There are two routes. One is to so streamline it by getting rid of allowances, whether by just getting rid of them or in fact substituting some other form of payment outside the tax system. One has to so simplify the existing PAYE system that you create the capacity, using this in the rather loose sense we

have used earlier, partly the existing people, partly taking into account the quality and competence of the people, and in that way it is conceivable you could create the capacity to put the local income tax on piggyback. The other route is to move towards a system, whether you call it non-cumulative PAYE or something else, which depends essentially upon a majority of taxpayers rather than the minority being assessed at the end of the year. But in either of those ways you think that LIT could be done, but you do not think it can be done on top of the present complexities?

-A: Yes, that is within the PAYE field of course, and that is, as you know, by far the largest. There are still problems like the investment income thing which we would have to bend our mind to, but with staff relief we could do that more readily now.

Q: If you were told, "Come hell or high water we want local income tax and we are prepared to sacrifice a lot to have it, including a great deal of intermediate disruption", have you considered how you think it best to do this? Which of these two broad routes would you want to take?

-A: The elimination of the allowances without a doubt. I think that non-cumulation is a nice idea to play with. Whether it would be acceptable in this country now is a very different matter indeed. It may have been if in 1943-1944 people had invented a non-cumulative system of PAYE that would have been acceptable. I doubt very much now after PAYE has been running for 30 years whether people would go back to what is in fact a much cruder system which might involve fairly heavy overpayments during the year. This is a matter of judgment, but I am absolutely certain the real road to pursue is the simplification of allowances.

Q: Can I just follow that a bit? If I follow you rightly you are already heading on that road, i.e. the road of elimination.

-A: Our noses are pointed in that

direction, but to say "heading" I think is over-stating it a little.

Q: Could I go back to the three to see whether "heading" is used in sewing terms or sailing terms, or some other. The three so far are instances you have given us of possible measures which would be moving in that direction. If I followed you rightly the first one is something ministers are actively considering?

-**A:** Yes.

Q: The second two are active possibilities rather than ministerial views, would that be so?

-**A:** The difficulty about all these things is that a mere administrative change has no sex appeal for Ministers of either party and they tend to say, "We have a very full Finance Bill, we cannot have that." Give them an incentive like making room for local income tax. . . .

Q: That is what I was going to suggest. The thing gets different dimensions on different postulations but this would provide an incentive to set about the problem of streamlining and simplifying allowances in such a way as to provide house room to do the work.

-**A:** Yes.

Q: Can I just take that a stage further. Assuming that that incentive was provided, there are two questions which arise in one's mind inevitably. First of all, how far on the present lines of thought do you see that as an administrative matter capable of being taken; secondly, let us suppose for the purposes of getting some idea of timetable ministers say, "In six months we are going as far as we can in that direction" and wish to make room for income tax, what effect would that have upon the timetable? Are we talking about two years, five years?

-**A:** I think one is always going to say that the real way of introducing a local income tax is with the use of a computer. One is therefore talking about a minimum of four years. The benefits that one can get from the streamlining

of allowances can come immediately as soon as we change over, so the streamlining could be done in a year or two. One would still have I think to wait for the imposition of local income tax as well, but in the sense that one could alter the income tax system without reference at all to the local income tax as we hope to do, one can contain it within the timetable that one would visualise for local income tax anyway, and I do not think it would prolong it; it might speed it up.

Q: Can I just see if I have followed the consequences of that? There are three. First of all, the timetable we were discussing on the last occasion would still stand if necessary political determinations were made.

-**A:** Yes.

Q: Secondly, it would require willingness to embark upon an effective computer programme within that period?

-**A:** Yes.

Q: Thirdly, it would require political determination about matters which are administratively practicable in the allowance field.

-**A:** Yes. Can I just expand the last bit? I think there are two elements to the last bit. There are some things like building society interest and life assurance premiums which are more or less purely administrative. There are things like dependent relative relief, house-keeper relief, which has a political atmosphere, one is denying people an allowance, so there are the two things.

Q: May I put the question again, I may not have put it properly. Within our four to five year broad period, given the political decision that they want it and they are going to have local income tax, given the willingness to embark upon the computer programme within that time scale we are talking about, and given the adoption of those improvements or processes of elimination of allowances which are administratively feasible in your judgment, would those three as so defined provide for the four to five year time scale?

-A: I think they would. I would like to qualify that a little because that is very much my own opinion. I would like to talk to our computer people before I can say an unqualified yes. I do not know whether you would like to add anything

-A: I think the problem I see is how to fit this in with our existing computer programme. We reckon if all goes well to start computerisation on a national scale in the early 1980s and complete it, if all goes well, by about the mid 1980s. If one were going to simplify I am not sure that that would speed up that timetable very much because there is so much of it that it is simply the process of getting computers installed, getting information from the files on to tape and all that, and organising the training, and accommodation. If one is thinking about some local income tax superimposed on a computerised system of that kind, I would have thought either one has to think about it at the end of that period, which puts you back well into the 1980s, or one has to work it out beforehand and try and phase the two changes in together, which is not an attractive prospect.

Q: As a layman I am moved to think, given thought, that that latter point is feasible because many of the life assurance companies did that between their first and second generation computers.
-A: I think perhaps the best thing we can do is to have a word tomorrow and let you have a note about it.

Q: I think this would be most helpful. Could I go back just as a framework to these questions to a point that I think we discussed when we first started, and it is still very much in the forefront of our minds. I crudely over-simplified to make the point. If I can put it this way, we would think when a major debate comes about – and undoubtedly a major discussion will take place on whether there should be local income tax or not, certainly it is one of the two or three most important points likely to be under discussion – most of us would prefer a decision to be made upon the

basis that yes it can be done, it is feasible, these are the costs, the drawbacks, the disadvantages and the political problems.

-A: Yes.

Q: But it can be done and here is at least one model, or even two models, two or three ways of doing it. We will probably assess its impact upon local government, and society and employers, and come to our decision upon the balance of advantage and disadvantage, using those terms in the widest sense, rather than get bogged down in an amorphous discussion of is it possible, or is it not, and are we talking about something which cannot be done or can be done. It seems to us apart from anything else it will end in the sort of morass so many of these discussions have done before with a decision which is not a decision, it will be shelved, it will rear its head again later and all go round in the cycle once again. So we are most anxious to identify by what steps and with what repercussions the thing can be done. If I may put it in quite a different way it could be a universal theme of many of the rate-payers' associations and laymen saying to us, "If the government decides to do it, it will do it as it has done in many other awkward things. What you should be looking at is what will be the cost of the damage which will be done". It is those reasons we are primarily concerned with, could it be done this way and fully understanding the drawbacks you consider, political, administrative and any other way, which would flow from it.

-A: Yes.

Q: And if I could just add, getting a realistic sense of money costs and timetable among other items.

-A: Yes.

Q: Can we come back to the allowances again? You have said that your own judgment is that if you were told that we want a local income tax the route you would want to go is not to go non-cumulative but to use the

present system and to say, "We will simplify a whole variety of aspects of the present system". Mortgage interest and insurance premia you think you have a plan for, which would be much simpler if only they would find time in legislation to implement it.

-A: Yes.

Q: That is in a sense relatively easy, it does not have an emotional content, and it simply makes a claim upon that very scarce commodity, parliamentary time. You mentioned children's allowances. You mentioned some of those things like dependent relative allowance. Are there a whole host of those which you could regard as . . .

-A: Not a whole host.

Q: What is there left?

-A: Dependent relative, housekeeper, the additional personal allowance (this is usually in a one-parent family), daughter's services and that is probably it. There is the blind allowance, but I do not think there is any chance at all of that going. One would not necessarily want that to go; one could accommodate the blind allowance.

Q: I have seven: children, building societies, life assurance, dependent relative - I am taking the whole lot.

-A: Dependent relative, housekeeper, daughter's services, blind persons, single, the additional personal allowance.

Q: I am leaving the blind out because you are saying that is to be continued.

-A: I think somehow, yes.

Q: That leaves broadly seven divided into two categories. Those where you have formed the view that it is administratively feasible, three of those, and four where either no view is taken as to whether it is administratively feasible . . .

-A: There are three categories. Child allowance is one where we are on our way, building society interest and life assurance would be a second category which are administrative, and the rest would be in a third category.

Q: We have identified building societies and insurance premia, this is something which you know you can deal with if only it is given appropriate parliamentary time.

-A: Yes.

Q: The second category which is the housekeeper, daughter's services, there are four headings under that, these all have a certain amount of emotional/political content.

-A: Yes.

Q: People's views might differ about their weight, but basically your postulate would be the way is to abolish them.

-A: Yes.

Q: Now children's allowances I think is the third category because you have got something here which I think it is inconceivable in practical political terms to say that you will get rid of this without replacing it, and therefore that is out.

-A: There might be two views about whether you get rid of child allowances in the higher rates . . .

Q: That is a quirk.

-A: Yes, but in work terms . . .

Q: I must confess I myself am not quite clear how far we have got on children's allowances, what the public position is about children's tax allowances.

-A: The Child Benefit Bill is now an Act; it received the Royal Assent this summer. The intention is that child benefit takes over in April 1977 from child tax allowances. There may be an interim period depending on the rate of child benefit when you keep child tax allowances for a child over 11, because child tax allowances are at three rates depending on the age of the child, and the child benefit initially will be at one rate only. So I think if all goes well, if the computer operation goes as planned, 1979 should see the end of child tax allowances for the basic rate taxpayer.

Q: The child benefits to be payable – are they taxable?

–*A*: No.

Q: They are straight cash payments?

–*A*: Yes.

Q: And they are paid to everybody irrespective of income?

–*A*: Yes, they are like family allowances except that they are tax-free and they will be paid for all children.

Q: Here you have a major emotive subject as between child tax allowances on the one hand, and the other four allowances you have referred to on the other. I imagine you would agree that child tax allowances are much the most emotionally charged business?

–*A*: Yes.

Q: That is already on the way to what can be described as a solution?

–*A*: Yes.

Q: If I may interrupt could I ask for clarification on the mortgage interest allowance? You have referred each time to building society interest yet, of course, there is a substantial amount of interest which will continue even after 1980 to be allowable for income tax purposes which is not payable to building societies but to other mortgages for example. Is there any potential administrative problem there?

–*A*: No, I do not think so. Although the numbers of those are substantial they are small, of course, in relation to building society interest, and this is something we feel could be accommodated.

Q: Can they be deemed to be within the 15 per cent or whatever it now is of people borrowing that amount of money – coterminous with the 15 per cent or so for whom you have to have end-of-year assessments anyway? Is that the answer or not?

–*A*: Roughly. We try to deal with as many of these as possible through the coding but, insofar as they tend to be the better-off and insofar as the adjust-

ments at the end of the year are on the whole for the better-off, yes they would be coped with but not necessarily coterminous.

–*A*: I do not think it is inconceivable that the scheme Sir Norman has been discussing could cover at least some of these.

–*A*: We would certainly try to.

Q: Could I turn to a point related to my colleague's, going back to the timetable, again on the postulation that ministers decided that this was the path to be adopted, clearing the workload and getting simplification of allowances? On that basis, if I could first make the assumption that there would seem to be no major problem of time in getting rid of that first group, what would you wish the timetable to be for the remaining group of four, on the assumption that it was still desired to bring in the local income tax in five years from the ministerial decision? Would one have to say that you have to get the relief by . . . ? Would it be desirable or necessary to fix some time scale, or would you expect that to fit into place?

–*A*: I do not think so. Perhaps I can put this in proportion by saying that if we had the sort of regime that we are seeking for the life assurance premiums we think we would save about 1,500 staff; if we had that sort of regime for building society interest payments we would save another 1,500 staff in addition. Getting rid of the allowances, would only be in the hundreds – three or four hundred – so it is not nearly such a big problem.

Q: It would be minor?

–*A*: Yes. The problem is much more the training of people in learning about the many and varied conditions of giving these allowances – of cluttering up immature minds with all this knowledge, and the general inhibition on the working of the office as a result of that circumstance. If one were getting people in at 16 as tax officers and saying, "All that there is is an allowance for a single person and an allowance

for a married person", one could see how much easier this would be for those people. One does not clutter them; they have room for other things.

Q: They are a brake on the working?

-A: They are a brake on the working rather than a large addition to the work in their own right, so to speak. One has always to be on the look-out for them. One has to speak to people at the counter and bear in mind what they may be entitled to.

Q: You were talking about the staff savings on building societies and life assurances. Is there some general figure as far as child allowances are concerned?

-A: It is something fewer than 2,000—of the order of 1,500 to 2,000.

-A: My figure for all these things is something like 5,000, so I think that about adds up, does it not?

Q: Can I take two different points of view on the path of eliminating and improving so that the workload is reduced? First of all, would there be any other major drawbacks—if drawbacks is the word—to the path which says, "Let us clear enough working space in a little time"? Still in the PAYE field and apart from those matters, are there any other major points we ought to take into account?

-A: No, I think that would be as much easement as it is possible to give at all. I cannot think of any other circumstance. If I can just illustrate what it would mean, I have indicated earlier today the worry I have on the employers' behalf of their being deluged with constant changes of code numbers, as some large employers are. If one streamlined the system so that the only change occurred when somebody was married or divorced then the number of informations of that kind to the employer is enormously diminished. One does not often get married more than once a year. I think this fact would mean that the employers themselves would have a much easier time. There would be a code number at the begin-

ning which was simple in form. They would apply that throughout the rest of the year. I would have thought that if you asked them they would tell you that on that basis, that there are these variations that we were talking about, they could do.

Q: Those are things we have to note. Turning it the other way over, suppose again the path of elimination is followed and we streamline, are there any uncovenanted benefits to the Minister saying, "I am going for LIT"? Does he pick up any benefits as well as all the drawbacks? Is the system as a system in any way improved? Is there something which otherwise might not be done which is rendered capable? Is the presence of a computer something which would have side advantages apart from the ones you have described?

-A: The main benefit from our point of view and the administrative point of view is a much much simpler system. From the point of view of general equity the child benefit, the child allowance, is self-balancing and solves itself. The building society interest and the life assurance will not make any difference at all to the taxpayer. Insofar as it will make a difference it will help him on cash flow because he will be able to pay by deduction of tax whereas now he is paying more or less in full. With the other group of allowances there would certainly be a howl from many people that we were depriving somebody of an allowance for a socially beneficial thing. How far this is sustainable I do not know. As I say, the Royal Commission thought that the housekeeper allowance was already dead and should have been withdrawn anyway. The main problem will be on the dependent relative allowance and there, without being a hard-hearted bureaucrat, I do feel that the original idea about giving dependent relative relief has much faded with the increase in social service benefits—the increase in the retirement pension and so on—because it is mainly in respect of an elderly dependent relative that we meet a claim. I would have thought that any stout-hearted government could

have withstood this fairly well and, although it might be claimed as a deficiency in the new system it would not really be so.

Q: Taking still just the PAYE field, if I followed it subject to the qualifications you have made about the direction and the administrative and political decisions necessary, plus streamlining and other matters, given the timetable we have been discussing of something of the order of five years, given the conditions you have described qua PAYE, the system would be workable and could take in LIT on the broad basis of the McIntosh model or something which had no greater handicaps?

-A: Yes, I would have thought that was right.

-A: I am a bit unhappy about the timetable because of computerisation.

Q: As I say, subject to the qualifications you have made, and you will give us second thoughts on that. There is a side shop so to speak; improved though it may be, if it were feasible so far as the PAYE system is concerned, then we have the separate problem of investment income. Again on the same theme that the ministerial decision has been taken and there is acceptance of the direction that you are describing, saying that it must be done by relieving the workload, streamlining and simplifying plus the other parallel points you have made, where does that stand us now on the investment income side? What are the steps to be taken there?

-A: Here again, on the McIntosh model there was a suggestion which would have solved the whole problem if it was regarded as acceptable. It could be that a government would accept it and all problems would be solved but I would have thought, out of the general experience I have had, that the proposals for this sort of rough justice, if I may put it that way, would be very difficult indeed for any Chancellor to steer through in the form of a proposal in the Finance Bill. There would be a loud cry about equity which would mean that a Chancellor, in the end, would have to vary the rate on invest-

ment income to agree with whatever was the local authority figure, and that variation would involve us in a fair bit of work which we do not at the moment get. I am not sure that any suggestion that we have now discussed, apart from the general simplification of the system, would help us on that aspect of the work.

Q: I am perhaps regarding the investment income proposal as less important than some others against the background of having decided that there would be an alternative. That is the postulate. Does not the emotion about it turn a little bit upon the context of local income tax, because if you brought in a local income tax alongside the rates there is less emotion about investment income? Assuming you could not have varying rates of tax on investment there may be different emotions depending on whether this comes in alongside the rates or totally instead of them, but equally in either case do you really think this is going to be a terribly emotive issue in circumstances where in any case you have a different rate of tax for investment income?

-A: It is just my judgment. I would have thought so. I would have thought it would have been very emotive indeed. I am not sure of the figures but a lot of the investment income goes to the pensioner, and the pensioner is very very alive to this sort of variation. One of the suggestions made was that the rate to be imposed on investment income at source would be the highest of all possible rates. Another suggestion was the median rate. If one says the highest, it would meet certain of the problems but you would then immediately get complaints of "Why am I paying six pence on my investment income when the man next door is only paying three pence on his earnings"? If on the other hand one had a national median rate one would have the awkward situation, that one was charging investment income in some areas at a rate which was less than earned income. This would be very emotive indeed, I think.

Q: I am just trying to see how real this is. I do not quite know myself. I find it rather puzzling. If we start from the assumption that there is no ceiling on local income tax – and a lot of people have represented to us that if you did have a ceiling that would become the norm anyway – you then say that that does not give you a guide, but you start from a situation where there is already a differential against investment, and that is the situation. You start from the postulate that it is impractical to vary the tax on investment income. Would not you and your colleagues and your successor tend to go to a Chancellor of the Exchequer of whatever party and say, "If we are bringing in this local income tax on a basis which involves an increase in the totality of income tax then you will want to do the same as regards investment income, and we suggest you increase the basic investment income rate"? There is an investment income rate after all once you get above £2,000.

-A: This is on top of a varied rate.

Q: But could you not say at the national level that we simply increase the investment income surcharge and investment income is not charged as local income tax? I do not know there is a strong call from either party if you could do it that way.

-A: This is something we would love to do. One would love to take a scheme like that and say that this is the simplest way because, contrary to all that is alleged of us, we are really simple-minded people who like the simplest solution. It is just an assessment of how that advice would be received, and I am merely giving it as my view that if one said, "Here is a suggestion that Mr A, who has investment income, will have to pay three pence on that in addition to the other, and Mr B, who has earned and is therefore good, will have to pay six pence", they would say, "We are not looking at this at all".

Q: Could I get the context right because I do not want to waste your time if I have failed to understand it

properly? We see on the postulates you have given a workable situation for the PAYE field. What I am not clear about is the investment income field. I am not sure whether what you are saying to us is one of two situations. Leaving the PAYE set-up we have been discussing as workable, you could say that we do not at the moment see our way clear, but given the situation five years from now it is likely it is capable of solution. That is one possibility. The second is, "No, we could not possibly say it is workable until we saw the scheme, or at least an approach which we could measure", and therefore it is not workable, or thirdly some compromise between the two, namely that it looks promising and that it would not of itself stop LIT being introduced on the time scale, subject to the premises we have been discussing. I was not quite sure which of the three you were really indicating to us. I do not want to take up time looking at it if you could say that it could be done by one means or the other.

-A: I have forgotten which of your heads this was, but this might possibly be the "we will have to have another look at it" section. I think it would have to go in there because I am very worried indeed at the prospect of creating, for every holder of investment income below the investment income surcharge limit, a situation in which one was having to make an assessment each year. This is the worrying thing.

Q: Could we therefore put that on one side and say that that has to be looked at – it may or may not be but you want to look at it. That is a matter, obviously, of some considerable urgency. Will you therefore for the moment assume that the answer in due course is yes. Whether it is a happy yes or an unhappy yes, it is a yes. And we have understood what the conditions are upon which it must be advanced. Given those two fields, on that postulate only, is there anything else which is of importance which needs to be taken into account, apart from the matters we have discussed in the PAYE field and

the consideration of the practicality of the investment field which we leave momentarily on one side?

-A: I do not think so - one would hope we have left out nothing of major importance. I think there are a number of things of rather more minor importance - for example what one was going to do about the self-employed. One accepts that they would have to pay a local income tax on top of the present tax they pay. The big question is where. Do they pay it at their residence assuming that they work elsewhere, or do they pay it in the local authority area where the profits are earned? This is a problem that is perhaps rather more yours than ours.

Q: That is just a question of taking a policy view is it not?

-A: That is a question of taking a policy view.

Q: Rather than an administrative block as to whether it is a sensible way to work the scheme?

-A: Yes. The other problem that might be both policy and administration - probably more policy than administration - is the question of the man with two houses. Did I see somewhere the figure of 9 per cent of houses being second ones? The figure is fairly large and growing. One has got to make up one's mind where the payment is made there, assuming that two payments are not made. The impact of that in the local authority area which has a lot of holiday homes - that is all policy. The administration side is really to sort this out to determine whether or not to charge somebody in a particular place.

Q: The policy question there is partly whether there should be rates as well, is it not?

-A: Yes. I think if there were rates as well it would be solved. If it is in substitution for rates I think, with respect, you have really got a problem.

Q: You have three postulates there, do you not? First of all whether income tax on its own is charged on a main

residence; the second is to say that they are consumers of services and charge them wherever they have a house, it being up to them whether they consume the services they pay for or not; or, thirdly, the difficult problem of whether it is running in parallel with rates.

-A: Yes.

Q: Presumably, administratively the simple thing would be for the payment of the local income tax at the place where the principal residence is declared for present tax purposes?

-A: Although, of course, main residence does not really matter for tax purposes at the moment. One could conceive of a part-time job in one place and a main job in another. The difficulty would be, for example, to tell the employer that you do not do anything at the part-time job. This is the sort of administrative problem I was thinking of.

Q: Those are the only main problems?

-A: I think so. Am I right?

-A: Yes, I think so. There remains the determination of residence which you have talked about already, and there remains the task for the employers. One would like to hear what they think about it.

Q: But is not the presumption that if you simplify the allowance system by getting rid of allowances that creates capacity in the employers' offices as well?

Q: This was the gravamen of your point before. A side aim would be to ease the burden because of less frequency of change and complexity.

-A: Yes. I would be more happy in terms of our offices of there being, as it were, complete compensation, than I would be in terms of employers, but I do suggest that you might talk to them and discuss this.

Q: I fully take the force of your point.

Q: When one is dealing with insurance and mortgages is there any notion that one is increasing the burden on the insurance companies and the mortgage companies? As I understand it now, the situation is that I take out an insurance policy. I then tell the Inland Revenue and my tax code is adjusted, so the work is between me and the Inland Revenue and there is no work involved for the insurance company or the building society. On the scheme you are indicating would this not increase the work to the insurance companies and building societies?

-A: Yes, it does slightly, but we have talked to them about it and they showed no disposition to argue with this. The general theme is that one gives, so to speak, tax relief in the form of reducing the amount of the premium that the insured pays to the life company, and then the life company sends a bill to government saying, "This is the total of the amount we have allowed. Please send it", so one makes up the whole amount.

Q: You see it as a very small increase?
-A: It would be an increase, a small increase, and one they would be prepared to accept. They are more worried about the cash flow than they are about the work.

Q: Again on the postulate I made earlier that a decision can be defined as to investment income and that the overall system is a workable one upon the assumptions you made, can I go back now to the broad order of cost? When we were discussing this on 16 July I raised a question—again assuming that Ministers decided they wanted it, that the scheme very broadly followed the McIntosh model, that it was residence-based and that you have got to get that into the system, and that the rate might be varied. Given that, I asked then would it be right to assume that the £70-75 million bracket plus or minus 5 per cent gives us a pretty reliable bracket, and you said with qualifications that that would be right and made the point about its continuity and

so on. Can I return to that because having seen what the framework is today as to what I call the elimination of the allowances part that, as I understand it, would not materially alter the timetable, subject to your point about computers. Given those points, are we still speaking about that figure or a different one or that range of figures as the broad order of magnitude?

-A: Insofar as there is a real figure it is accurate in the sense of being as nearly arithmetically right as we can get it but I think what we have been saying to you this afternoon is that it cannot exist in its own right. We cannot see that we could do LIT without at the same time ridding ourselves of other jobs. In that sense, if we rid ourselves of other jobs then, of course, this cost would go down, so I think it is only a starting point and not a real cost in the sense that it is something that could be put into operation on that basis.

Q: Going back to the same context in which I was raising it there, what we were saying in fact, with I think some support from you, was that although Ministers did not always ask what the cost was in the past they would expect us to ask the question for them. In that context and in the meaning attached to it then a similar meaning is attached to it now, provided that the policy were followed?

-A: Yes.

Q: That arithmetical cost would still be of the same general order of magnitude?

-A: I think it would be different. One would be in a different ball game as they say. It depends what one is comparing it with. If one says that on top of the existing system there is another £70 million, say, but then one alters the existing system, I would have thought that the additional cost compared with now is something less than £70 million because one, as it were, has lowered the floor from which one started.

Q: The figure of £70 to £75 million if it has validity is the cost as compared

with what otherwise would be the cost. What you have said is that we cannot superimpose that cost of £70-£75 million and all it represents in terms of people actually doing jobs on top of the existing system, and that one understands. If the existing system is changed and simplified then from that simplified position does it or does it not cost £70-£75 million to do the job? One must always put the cost as compared to what it otherwise would be.

-A: I am not sure. It depends what additional operations we are costing here. Could I again write to you about that? I think this is something where we will just have to go back to base to see what it was we costed previously, and to see how far that is changed by the new dimensions we have suggested.

Q: Taking the question about base, we identified three areas of simplification: one is what you have in mind for building societies and insurance companies; the second is the four allowances which are sometimes described as archaic allowances, and they are very odd in a modern world; and the third area is the child tax allowance thing which clearly can only be removed if it is being replaced and there is a legislative plan for replacing it.

-A: Yes.

Q: Is the implementation of all these three simplifications a pre-condition of LIT being possible, and is that the base, therefore, upon which we should calculate the cost? Are all these three required before LIT becomes possible?

-A: I would have thought one must have the child allowance got right; one must have the building society and life assurance; I do not think the minor personal allowances....

Q: These two are necessary conditions and the four others are a potential extra?

-A: Yes.

Q: That was your earlier answer to me. Those are the ones which seem to be administratively feasible now and the

others would be a minor benefit but not major, as the figures show.

Q: Could I ask a question in elaboration where I am a little lost? I think your figuring was that these three simplifications of the allowance system would save of the order of 6,000 people. The figures we were given in July were corresponding to the £70 million, so that something like 18,000 more people would be needed in order to work LIT on top of the present complicated ordinary income tax system. I think the thing that needs to be reconciled—I think I see the reconciliation but I would rather have it from you—is how you see it as workable that something that would cost 18,000 men more is possible by taking 6,000 away?

-A: The thought had occurred to me that you might put that question earlier on. I think the answer is this. We have given the figures which build up to 6,000 on the basis that each of these things is done separately. If one had the existing system and did not have the building society interest one would save, say, 1,500. What we have not done, I think, is to cost them—and I am sure there is an economist's word for this—on the basis that they all went together, that is cumulatively so to speak. If one did not have building society interest then staff would certainly be reduced by 1,500, but not having building society interest might make the next one easier, and the effect of all of them would be more than 6,000, I think, so one gets nearer this way.

Q: I thought that would be the line of answer, and that would suggest that the net addition for LIT compared with no LIT and your simplified allowance system would be considerably fewer than 18,000?

-A: Yes. This is why I asked whether we could look again at the £70 million.

Q: May I ask a parallel question? It seemed also possibly to flow from one of your earlier answers that you have two difficulties in the present system—actual manpower and what one might

call thinking time and organisation time - and staff would be retained anyway even if you relieved yourself of some, and that therefore would be something existing at the time that this new exercise started within the present system and would not represent a staff addition. There are several possible combinations.

-A: Yes I do agree because one of the things is that in order, for example, to take the child allowance away one has to have extra staff to do the coding that that necessitates, so one has got a wavy line about this.

Q: So the additional cost of staffing numbers needs to be put aside for correction?

-A: For looking at again, yes.

Q: If you are to revise the estimates of cost and staff numbers, could they please be based firstly on the county level - then on non-metropolitan counties but with metropolitan districts and the London Boroughs - and finally to the 459 basic smallest areas? I think it is important to realise the dimensions of the additional burden incurred by those additional layers.

-A: We will see what we can do, yes.

Q: If we are trying to set up postulates it seems to me we have to postulate that while there would be no doubt practical limits upon the rates we do not have a ceiling on the rate.

-A: You are thinking of a substitution or supplementation here?

Q: Can I throw that back by asking another question? Am I right in thinking that the relevance of the question of cost to the question about whether you are having substitution for rates or going in parallel is that you make a different guess about the LIT rates of tax? Is that right? Is that the relevance of it?

-A: Yes. There are two things really - one from our point of view and one from the local authorities' point of view. All the figures we have been giving to you, taking supplementation first, are on the basis that the staff now employed

in the local authorities' offices will still go on doing the collection of rates. If one has substitution one saves whatever that number is. Within our office the main difference, I think, is the complication that would be introduced by varied rates. We have been thinking in terms of a maximum of, say, 5p with the ability for the local authority to fix a rate at any $\frac{1}{2}p$, which would mean 10 tables, and trying to gauge what that would mean in terms of extra work both for ourselves and, impressionistically, for employers. If one has substitution then presumably the range of rates is much more. One introduces greater complication mainly in employers' offices - the greater number of tables which that would involve.

Q: I think we have two separate questions here. Just to deal with yet a third the $\frac{1}{2}p$ I imagine we would all feel would be a reasonable thing to be prescribed in any conceivable LIT rather than introducing new coinages as it were. I think we have two rather different questions here. One is, is there a problem about unpredictability of the number of rates of tax as opposed to the problem about the possible and potential range, given the hypothesis of substitution of rates on the one hand and the hypothesis of rates going alongside on the other? Let me put it this way: let us say we were talking about substitution for rates for the moment, and going beyond that, in which case the average might be 10p. If that were the situation does it significantly affect the cost of administration whether or not you have a ceiling at, say, 12p?

-A: Not our administration, but it would the employers'.

Q: Have you any way of assessing to what extent this would be?

-A: I would rather you asked the CBI about that.

Q: There is a very serious problem underlined. It is represented to us by some people that a local income tax with a ceiling on the rate of such a tax would very rapidly become little more

than a hypothecated tax. Therefore there would be a difference in kind from one where there was at least ostensibly a genuine freedom of action, so it is a serious question and I think it is rather important.

-A: I was trying to answer it seriously. If one just tries to visualise it in the PAYE field where most of our clients are, what we contemplated doing was on the basis that the rate is announced by 1 October. This would be necessary, of course. We would incorporate that in the code number. We would just pick up a certain county or certain community charging, say, 12p either as 12 or as some letter that would go in the code number. To that extent it would not matter whether there was a ceiling or not at that point. We would then forget about the rate until, at the end of the year, there was the task of sending the money to the local authority. There again, as we imagine it, this is going to be a simple exercise on a statistically sampled basis of saying that the income arising in that community is so much. What is the rate—12p, 14p, whatever it is? That is the money to which that community is entitled, so it does not matter from any of those processes whether there is a ceiling or not. In the employers' offices the greater the number of possible variants of rate the greater will be the literature you have to send and the greater the choice of reference they will have to make. So this question is simply how much more work will be given to the employers because, as far as I can see from our point of view, it does not make any difference.

Q: So far we have been concentrating on the cost to the Revenue and the cost to employers. I wonder whether there is anything you can say about the cost of the actual dealing with tax affairs to the taxpayer where, of course, there are two categories: the simple people who are single employees on the PAYE with nothing much more, and then the complicated sort of people with several sources of income where, at the moment, their accountants seem to have

to write to about eight or 10 tax offices. Do you envisage the cost to either of these categories of taxpayer in terms of time or money as altering significantly under the kind of scheme we are envisaging?

-A: It would certainly alter and alter upwards, of course. "Significantly" I should not have thought. If it is established that the local authority in which you reside is charging, say, 15p and, therefore, the basic rate becomes in effect 50p instead of 35p, that is simply a question of alteration of rate and, although it will be necessary to check that indeed it is really 15p and indeed the 50p has been deducted, I would have thought that is the limit of the extra work.

Q: May I ask about the reduction in personal tax allowances?

Q: Yes. This is E157 which you have just given us.

Q: I think this is a possible simplification that we threw at you late in the day, and you have been kind enough to send us a note more authoritative than was justified really. You do say in paragraph 5 of your note that the proposal would dovetail into the existing pattern more closely and be far more acceptable to employers. You then say that there are two serious disadvantages. I want to check on the disadvantages because there is the scenario for local government finance in which what appears to be a disadvantage could be regarded as an advantage. The first one is that you say it would not be an additional source of finance but would be an alternative to the Rate Support Grant, all or part of it. There is one case for saying that local government taxation should be more autonomous and more responsible without necessarily giving more access to additional resources, so there is a scenario on which that disadvantage could be an advantage. On the other point, in paragraph 7 you make the strong point that by deduction from allowances the local income tax would at best be only mildly progressive

because it would immediately bite just above the tax threshold. I would just like to confirm that this does not necessarily mean that the overall tax position, when you take local and national tax together, would be any less progressive? It is simply that the local tax would pre-empt the first bite of the income tax? Is that correct?

-A: Yes.

Q: So that there could be an argument in favour of that. We might want a local income tax to bite sharper (i.e. less progressive) on accountability grounds as distinct from the macroeconomic case for a much more progressive national level?

-A: Yes. If I could just make a point on each of those; on the first one I accept what you say about the shift in responsibility but the difficulty we saw was that, assuming that local authorities as a whole were to get the same revenue from this source as they got before from RSG, it would mean that some people's thresholds would have to come down and this seemed to us, given the present level of tax thresholds, a very real difficulty. If the average amount collected remains the same, but you have variation with some people a bit higher and some people a bit lower, then the place where you have to apply the penal rate has to be lower still presumably. On the second one, I accept that if you look at the tax grading as a whole it does not become less progressive than now, but given that particular bite goes to local authorities. . . .

Q: If in a certain scenario the disadvantages tend to be regarded as advantages, and if there are decided administrative advantages in doing it this clever way - some would say over-clever way - what is your overall attitude to this proposal? Let me be specific: would you prefer this, from the administrative point of view, to the kind of proposal or circumstance you have outlined to us earlier on about abolishing the series of allowances as a necessary pre-condition to making the introduction of a local income tax more

workable? It is a different scene, is it not?

-A: There are the practical problems which we spell out in the earlier part of the paper which I think would be difficult. If you are saying would we need fewer staff to work this than we would to work the full load of a local income tax system of the kind we have been discussing, my own view, subject to what my colleague may say, would be that we would need fewer staff for this, because it would be a much simpler operation.

-A: I was wondering about cases where the reduction of the allowances gave minus allowances.

-A: It could be an absolute minus, could it not?

-A: This is a present difficulty - for example a retirement pension which is coded in and so reduces the level of allowances which can be given against a part-time job. If a further reduction turned that into a minus figure, as it were, so that one was, in a greater number of cases, having to make an assessment to get taxes on retirement pensions that would be a nuisance, but how much this weighs against the totality of the saving elsewhere I am not sure.

Q: I wonder whether it would be appropriate for us to push a little at the other door - the door of a non-cumulative system? The case that has been made against it so far is in terms of taxpayer resistance, which is clearly understandable. Leaving that aside, what other arguments would you see between that door and the door we have been discussing at length this afternoon? In particular, would the door of a non-cumulative system allow substantially bigger reductions in staff, in the workload and so on?

-A: We did a fairly large exercise on this about four or five years ago, just before the ideas of the tax credit scheme were discussed, and we came to the general conclusion that with the existing tax structure, with all these allowances and other problems that we have been talking about earlier, the staff saving

would not be great. There would be some but it would be fairly marginal. It would have a number of difficulties. Most of these can be brought together under the heading, as you said, of taxpayer resistance. The advantage to a taxpayer under the cumulative system of getting his tax refund immediately if he went sick and his income dropped would, of course, go under a non-cumulative system. One would not have, in the jargon, in-year repayments. They would have to wait until the end of the year. Whether or not one would regard this second point as a disadvantage is an open question, but one would not make repayments to strikers. There are those who would regard that as a major benefit; others who would regard that as a major deficiency of a system. The third thing is that it has always been accepted since 1949 when we abolished the practice of assessing short-term benefits—sick benefit and unemployment benefit—that it is a desirable end that somehow or another these payments ought to be brought in as income. There is some faint hope that with a cumulative system this might be possible, and one would like the structure to exist because of it. We would have done it with a tax credit system, of course. There is very very little hope at all of being able to tax them with a non-cumulative system. This you may regard as a negative benefit, that we would be able to tax something which we are not taxing now, but in the councils of mighty this is regarded as a factor.

Q: There are two questions from that. I find it a little difficult to understand why you think the labour savings from a non-cumulative system alone would be modest after your earlier description this afternoon of all the complications in the present cumulative system, where information has to be changed at frequent intervals through the year. That is question No 1. Question No 2 is that experience abroad suggests that in non-cumulative systems the outcome, because of fluctuating incomes in a progressive tax system, is

that most people over-pay tax during the year. Can that not be argued in some way as an advantage? Clearly it is an advantage to the Government as a temporary source of help towards the deficit and, arguably, also an advantage to the individual because it is a sort of forced saving and a nice lump of money appears at the end of the year which, I am told by many people in foreign systems, comes as a pleasant surprise.

-A: I think your question was in two parts. On the first—the reason for the small amount of saving—it is true that some of the things which I have been describing earlier as attached to a cumulative system would disappear. But instead of our present system of assessing only one person in four at the end of the year, because in three out of four the cumulative system does get the tax right, we would be having to make an assessment in 100 per cent of cases. On the balance of these two things there was this very small difference.

On your second point, yes, we also have heard that in Australia and America this system which tends to make for overpayments is welcome because people have this nice sum of money. In America it is said that it is very welcome because they can then pay their state taxes with it. This is just an assessment of our own, which may be wrong, about how people here would think about it. It could be that we are quite wrong in this and that people would welcome this. Our view at the moment is that people would resent having to pay, and know that they were paying, too much in the course of a year, having been used to a system which got it more or less right. This is a subjective judgment, it may be wrong.

Q: Perhaps in these inflationary times, giving the Government an interest-free loan and being paid back in depreciated money is not a very attractive proposition.

Q: In the context of the present system we are moving to a situation of abolishing child tax allowance and sub-

stituting, as I understand it, tax-free social security payments according to the number of children one has. Whether or not they will stop at some income level apparently is not yet clear. Is that right?

-A: Child benefit will supersede the child tax allowance at the basic rate for everybody. There is a separate question concerning the position of the man liable to tax at the higher rates.

Q: The non-cumulative system has often been associated with the concept of negative income tax in one form or another, like the old tax credit scheme. I suppose the presumption is that we are moving away from that with the legislation on children at the moment. Is that right? I am trying to see how far non-cumulative is an option. Let me put it this way. The Government says, "We must have a local income tax at any price. We can do it two ways. We can simplify the PAYE by taking out these two/three areas, two of which we have plans to take out. Or we can go for a non-cumulative system under which we might possibly achieve some of the things we are trying to do by this action on children on the PAYE system, by a negative income tax form of approach". Are you now, by virtue of this legislation, on children in particular, moving rather rapidly away from the tax credit scheme, local income tax, sort of non-cumulative system?

-A: We would have said that with the other big sphere which you touched on, social security, with the big increases in retirement pensions we moved away from that some while ago.

We would say, therefore, that the need for the dependent relative relief has gone. Nobody has recognised it. This is what has happened with the child allowance, except that the next step has been taken and the child tax allowance is going. So to that extent considerable steps have been made. Of course the tax credit scheme did try to make the disappearance of the dependent relative relief more acceptable by the way in which the retirement pension was treated. There was the idea of a

direct payment of something representing the tax allowance. There was also a deduction of tax from the pension, but the payment was more than the deduction of tax, so that the total effect to the pensioner was an increase in the amount of pension.

Q: At one stage you said that though the tax credit scheme as conceived in the Green Paper was in the context of a non-cumulative system and it involved as set out a move to non-cumulative PAYE, it was not, as I understood you, an essential characteristic of a tax credit scheme or negative income tax type of approach that it should be non-cumulative. Is that right?

-A: Yes. The allowances were so simplified that it did not matter very much whether it was cumulative or not.

Q: And the non-cumulative elements were not an essential part of this kind of scheme, and the case for the non-cumulative was partly based on the two or three things which you mentioned a moment ago?

-A: This is right, because again one had only two levels of payment of credit, a married man and a single person. Providing that status stayed the same throughout the year. . . .

Q: We just want to see the general relationship between these things. If one proceeded towards a local income tax by the route of simplifying the PAYE along the lines of existing legislation on child tax allowance, etc, doing what you have plans for on mortgages and insurance contributions, and possibly picking up the four odd allowances, one has then created a more simplified structure into which local income tax could be fed. Does it then become more difficult to go back to the negative income tax concept? I think it probably does. One has already moved in the other direction on the children by substituting something which is of a different nature.

-A: The tax credit direction. I would like to think about this further. My initial response is that it would make it easier. One has to take the Green Paper

tax credit scheme and add to that a deduction of local income tax in addition to the basic rate tax on all the income that was in mind. One has to do a few sums because one is applying the rate to the whole of the income instead of, as now, to the taxable income.

Q: I am trying to test the politics of this from another angle. Your own judgment is that non-cumulative PAYE is a very difficult thing to introduce once you have had a cumulative one, because there will be taxpayer resistance. I am trying to see what options one closes on the tax system generally by going along the route which you suggest.

-A: If you put the question in that form I can say fairly firmly that you do not close the tax credit option.

-A: Is the difference not this, that under the tax credit scheme you taxed all income at a given rate and you gave a credit. The result was that there was a breakeven point at a certain level for a single man and for a married man. If you have a variable tax this breakeven point will be different according to where you live. If you think that is objectionable, then it is objectionable. I am not sure that it is.

-A: I do not think it is.

-A: The child benefit is really very hard to distinguish from the child credit that there would have been under the tax credit scheme.

Q: May I deal with two last matters before we attempt to summarise where we have got to? First, following the general line of thought that by the elimination path the way is cleared for local income tax and we have something like five years to make a decision before it begins to operate, given that order of timetable is there a need for any transitional arrangements, purely from your end, purely to make it function smoothly?

-A: I would not have thought so. In so far as there was, I do not think it is the introduction of local income tax that would necessitate it. I will give you an

illustration of what I mean. One might say that it is good that nobody in future should have a dependent relative allowance but that anybody who has got it should continue to have it. Transitions in that sense one might see. We might deplore it but we would accept it. The local income tax issue does not make any difference to that.

Q: Secondly, may I ask an obvious question, which I imagine has an obvious answer, but I want to be quite sure that my mind is absolutely clear about it. Am I correct in assuming that you see no other sensible path to providing a situation where local income tax - whether desirable or undesirable is a separate matter - is at least a reasonable, practical and acceptable possibility in an administrative sense, other than the one which we have explored generally?

-A: No, I do not think so. If one has as a premise the concept that local authorities should be allowed to charge something on total income at a varied rate.

Q: At any rate, we may say in exploring the matter that you have under consideration no scheme apart from this general approach that could be regarded as a sensible one?

-A: That is so.

Q: I wonder if I could now try to summarise. Before I do so may I say that we are not forgetting that there are criticisms and objections made to local income tax as such by people other than you and your colleagues, Treasury arguments, and so on. Those we have set aside this afternoon because they are to be judged by different criteria. But I am not forgetting those, nor am I forgetting the employers. But I am leaving them out of this, because it is purely from the point of view of the way in which you would have to operate and manage it.

As I understand it, the points made are these - and I hope you will correct me if I am wrong. In the first place, you say that looking at it overall, not part by part but taking the sum of the parts together, your considered opinion

is that no satisfactory scheme can be mounted in the foreseeable future for a local income tax while the existing system operates in substantially its present form.

-A: Yes.

Q: Secondly, the only real road to providing for such a situation would be by eliminating those factors of the present system which because they are the most variable create the biggest miscellaneous and problem-creating workload within the structure?

-A: Yes.

Q: And if it were to prove practicable to eliminate those components of the allowances which are seen now to be administratively capable of elimination, that would be a satisfactory road, and by those administrative elements which are currently seen to be administratively feasible we mean mainly child allowances, the building society allowances and those relating to life assurance premiums?

-A: Yes.

Q: That while it may be an agreeable advantage to eliminate the others, they are not the essence of the exercise and do not account for the major problem.

-A: Yes.

Q: Though no doubt it would be welcome if we could?

-A: Yes.

Q: They differ from the first three, as I understand it, because they have a big political component, whereas the first three have mainly an administrative component?

-A: Yes.

Q: In order to open that road it is also necessary to have an adequate computer programme. You have made an additional two points on that. First, the programme has to be financially and materially adequate. Secondly, a way has to be found to phase the second group of programmes with the first.

You say that that opens a path. Provided we are following something broadly along the lines of the McIntosh model and a reasonable timescale is allowed, those factors together would create a situation where a workable and acceptable local income tax in an administrative sense could be achieved?

-A: Yes.

Q: As I understand it, that then leads to certain essential conditions which have to be created before one can do it. So far as the PAYE part of the exercise is concerned, that means removing those allowances that I have previously described, those where it is known now that administratively they could be removed, one of which is already on the way to removal. That would be capable of so reducing the staff load in the pure work sense, and easing congestion in what I might call the intellectual sense, thought processes, supervision and all the rest of it, as to make a scheme for local income tax broadly along the McIntosh lines workable in the PAYE field. I think you add from your point of view, though not necessarily from ours, that in your judgment the reduction in variations, problems of coding, and so on, which would be brought about by eliminating the allowances you have mentioned would probably make the employers' position bearable also?

-A: Yes.

Q: But, as you rightly say, that is a matter on which we must consult them. And that would then provide the necessary position so far as the work end is concerned, the general administration from your point of view and, so far as you feel able to judge, from the employers' point of view. But it leaves open the other side of the problem, namely that relating to investment income. You take the third of my postulates, namely that it seems likely that this will be resolved, but it is not immediately apparent how and you would like to look at it because, as I understand it, the central point you make is that the postulate which the McIntosh

model adopts you think would be inherently unstable politically?

-A: Yes.

Q: But it may well be possible to devise an alternative approach which would offer both political and administrative stability - that we need to look at?

-A: Yes.

Q: But if it be that that can be sensibly managed, then the two parts of the scheme, the PAYE side and the investment income side, would create a workable solution, subject to all the caveats which I have just attempted to state?

-A: Yes.

Q: Fourthly, as I understand it, the timetable from the time, if and when, Ministers decided to introduce local income tax would be something of the same general order as that stated in our earlier discussion, about a five-year period from the initial decision?

-A: Yes.

Q: Fifthly, in indicating ultimately to Ministers and others what staff and other costs would be involved, particularly in financial terms, you would want to look again at both the figure of £70/£75 million and the 18,000 extra staff because you would be starting from a different base point by definition?

-A: Yes.

Q: Your first inclinations are to think that it would lower them, but that would need consideration?

-A: Yes.

Q: Sixthly, as I understand it, there is not seen by you or the Inland Revenue any major alternative to this approach which would produce a workable situation and that the points I have enumerated so far cover the major heads which would have to be considered?

-A: Yes.

Q: The minor points include matters where a policy decision would have to be taken. It would be important that the scheme should settle it. It would not upset the administration whichever way it went but we would have to be clear which way it was going to go?

-A: Yes.

Q: Then, I presume we both share the view that it is important that at the end of our joint exercise the debate which finally takes place on this topic should be one which identified a workable approach and that there is a fair, comprehensive and coherent account of the advantages and disadvantages, in the widest sense of those terms, administrative as well as in every other sense, of having or not having a system of local income tax?

-A: Yes.

Q: Lastly, we leave six points outstanding for consideration. First, the matter of how such a scheme would deal with investment income. Secondly, the question of staff considerations, starting from the new base, that the proposal would involve. Thirdly, it would be necessary to assess the financial costs in whatever proved to be the right way, the arithmetic costs. Fourthly, you are very kindly going to look at the evident consequences of the possibility of levying it at the district level as distinct from the level at which we have looked at it so far, namely purely the county level.

-A: Yes.

Q: Fifthly, there is the point whether first instincts are right, namely that such a situation would be marginally favourable to any government which wanted to return to the tax credit proposal.

-A: Yes.

Q: Lastly, whether any transitional arrangements would be required on the

path that we have just discerned. Now, how many mistakes have I made?

-A: For my part, I think that is a wholly admirable summary. I accept all that.

Q: Once again, we thank you for helping us in this very difficult field. This is almost the only field in which no

one else can give us the advice that we need.

-A: May we thank you for the very courteous way in which you have received us and hope that you have an instructive day tomorrow.

Q: We are looking forward to it very much.

(The witnesses withdrew)

Evidence by H.M. Treasury

SOME ECONOMIC IMPLICATIONS OF A LOCAL INCOME TAX

1. The Committee have invited the Treasury to comment on some of the economic implications of a local income tax (LIT) introduced in substitution either of the domestic rates or of a portion (say 50 per cent) of the Rate Support Grant. The Committee's specification of these implications is reproduced in Annex A to this memorandum: Annex B provides some relevant figures some of which have appeared in earlier evidence to the Committee, but which it may be convenient to repeat here.

CONCLUSIONS

2. Our conclusions are that LIT on the basis proposed would:
 - i. constrain and complicate the Government's ability to manage the economy, both within the short and the medium term, in pursuit of basic macro-economic objectives (paras. 4-6);
 - ii. carry some possible risk to incentives and to the encouragement of inflationary wage demands (paras. 7-8);
 - iii. exert little effect on the distribution of personal incomes (paras. 9-11);
 - iv. influence marginally the location of population and industry (and, hence, the requirements of regional policy) (paras. 12-14);
 - v. add further to the difficulties of the equalisation process through Rate Support Grant (para. 15).
3. In reaching these conclusions, we have not prejudged the question of what form LIT would take. This is essentially an administrative matter, on which Inland Revenue have already offered views to the Committee. The precise economic effects of LIT would vary according to the timing of collection (whether on an on-going PAYE basis or an end-year assessment basis) and to the structure of the tax (whether a simple proportional tax or one more closely replicating the present national income tax); but the broad impact would in our view be the same.

MANAGEMENT OF THE ECONOMY

4. LIT would be a major fiscal innovation which could have serious implications for central management of the economy. Income tax is a key instrument of demand management. In contrast to domestic rates it has extensive and sensitive effects on consumption, investment and saving. Income tax may be envisaged too as an instrument for the achievement of distributional objectives.

The use of income tax for these purposes and the power to recommend to Parliament changes in the structure of incidence of the tax rests with the Chancellor of the Exchequer; the introduction of LIT would erode this power. It is because of these risks that the Treasury is obliged to advise against allowing the local authorities to have open-ended powers to levy LIT. Hence, as the Committee have anticipated in their guidance to us, local discretion over LIT would almost certainly have to be subject to an overall maximum or specified range of rates and/or to a limitation in the rate of change.

5. Apart from these general considerations, there are the particular implications of LIT as a substitute for domestic rates or for part of the Rate Support Grant. In substitution for the rates, LIT would increase the share of income tax in the aggregate national and local tax take, with implications for incentives and counter-inflationary policy. (Annex B, Table 1 shows the expected share of rates in total central and local government current income in 1975-76.) In replacement of a portion of Rate Support Grant, its effects would depend broadly on whether national income tax could be reduced commensurately with the saving to expenditure on Rate Support Grant. If it were, the effects would in principle be broadly neutral.

6. LIT in substitution for domestic rates would probably be a tax as clearly perceived by local taxpayers as the domestic rates, indeed possibly more so for those who at present continue to pay their rates annually or half-yearly. To this extent it might, through the electoral process, act as effectively as the rates as a restraint on local authority spending. On the other hand, LIT as a supplement to the rates might be a less effective deterrent because it would be less easy for local ratepayers and taxpayers to focus on the full amount of the revenue being levied by the local authority.

INCENTIVES AND WAGE DEMANDS

7. LIT as a substitution for domestic rates would mean a sharp increase in the number of individuals paying local taxes for the first time, at least directly. There are about 20 million domestic ratepayers, i.e. householders, compared with over 25 million in employment and charged with income tax (on Inland Revenue data) in 1973-74. Some domestic ratepayers (like old age pensioners) do not pay income tax while many income tax payers (working wives and other dependants living at home) do not pay rates. However, most households will include a person who is liable for tax on income from employment. The two figures may give some broad idea, therefore, of the increase in the number of those who would be paying local taxation *directly* for the first time if domestic rates were replaced by LIT. Many of the new taxpayers would be teenagers living at home. Some of these will already be making a full contribution to their 'share' of the rates; but others will not be contributing fully, or even contributing at all. For the latter category – and possibly for the former – local taxation would now become 'perceived'.

8. It is not possible to be categoric about the effects of a change in the rate of a tax – whether direct or indirect – on incentives and on the wage bargaining process. Certainly there is no consensus among academic economists about

these relationships; one reason for this is the difficulty of empirical testing and the associated inconclusiveness of the results. But, even allowing for these doubts, there is a presumption that high marginal tax rates on income may have some disincentive effects. Whereas LIT in substitution for Rate Support Grant, accompanied by a compensating reduction in national income tax, would not in principle make much difference to the marginal income tax rates of the majority of wage and salary earners, the introduction of LIT in substitution for domestic rates would result in an appreciable increase. Since marginal income tax rates are already high, there is a risk that possible disincentive effects would be further strengthened. As for the wage bargaining process, there is again no academic consensus to serve as a guide. Nevertheless, as the Committee will be aware, there are signs, in the emphasis that some trade unions and individuals are now putting on net-of-tax pay (rather than on the gross pay), that high marginal rates of income tax such as now prevail in the UK may indeed be of growing importance in the bargaining process. Again this would tend to call into question the prudence of a switch to LIT, at least in replacement of domestic rates.

INCOME DISTRIBUTION

9. Although domestic rates are commonly regarded as a mildly regressive tax, evidence recently submitted to the Committee by the Department of the Environment in their paper '*The Progressiveness of Local Government Finance*' suggests that when rent rebates and supplementary benefits are taken into account the existing domestic rate structure is, on the contrary, steeply progressive up to incomes of £2,000 a year and roughly proportional thereafter (1974-75 data). The Department's analysis indicates that LIT might make relatively little overall difference to the distribution of personal incomes, though the detailed effect would vary according to the nature of LIT (whether, for example, a simple proportional tax or a local surcharge on the national-progressive-income tax).

10. However, LIT could disadvantage low-income families, though again the precise effect would depend on the form of LIT. LIT, being geared to money incomes, would be as buoyant as the national income tax. This buoyancy is the product of fiscal drag whereby, because of the progressivity of the income tax system, the yield of personal tax rises more rapidly than the rise in incomes. Superimposition of LIT on the national income tax would increase the severity of fiscal drag. The remedy would be to revalorise income tax allowances and rate band thresholds so that in real terms the burden did not increase as a result of the increase in money incomes. But short-term demand management considerations may preclude a full revalorisation on this basis. It may be possible only to combine a limited revalorisation with an increase in the rates of tax, the effect of which would be to protect only lower income groups from the effects of fiscal drag. Moreover, to the extent that the imposition of LIT might pre-empt additional taxable capacity, a combination of partial revalorisation and income tax rate increases might not be a viable proposition. As a consequence the means of providing some protection for lower income families would become less accessible than at present.

11. There might be further distributional effects if LIT was substituted for the

rates, in whole or in part, arising from the impact on rents and property values in the private sector. The likely direction of these effects is complex and dependent on assumptions about the reflection of rates in rents, and the response of landlords to the change, as well as the consequences for house prices. The information is inadequate to make a firm judgment.

LOCATION OF POPULATION AND INDUSTRY

12. There are instances at various places in the country which show how in the past people have moved to the other side of the local authority boundary in order to escape particularly high rating. If there were marked differences in the levels at which LIT was levied, or conversely marked differences in rating levels, similar movements might be prompted again, although it is impossible to predict their scale or even their direction.

13. Variations in LIT rates, in the absence of compensating adjustment of Rate Support Grant, could be considerable. Annex II B to the Inland Revenue's evidence to the Committee, '*New Sources of Revenue: Local Direct Taxation*', shows the range of LIT rates required were LIT to replace domestic rates, based on estimates relating to 1971-72. (For convenience to this note Annex B reproduces the aggregate table for the United Kingdom.) For the UK as a whole, the required average increase in the standard rate of tax is 6.13p. But the dispersion around this average is large, ranging from 4.0p for Herefordshire (where the rateable value base is depressed by the derating of agriculture) to 8.05p for Sussex (where it is raised by the high value of residential property). Substantial disparities in LIT rates, unless they were narrowed over time through reductions in expenditure, might well encourage some net migration, of population and of industry and commerce, to the areas with low LIT rates.

14. It is unrealistic to suppose that marked inter-area variations in the income base and hence in the LIT rates needed to provide a broadly uniform standard of local authority services could be allowed to subsist; the redistributive mechanism of Rate Support Grant would have to be called in aid. The table forming Annex II A of the Inland Revenue evidence to the Committee shows that the county ranking for domestic rateable value is broadly similar to that for total net income. Hence if LIT were to replace domestic rates, this would imply a redistribution formula with Rate Support Grant rather like the present one, so far as the effect on actual payments to local authorities is concerned. Were LIT to replace a portion of Rate Support Grant, say by requiring all local authorities to levy LIT within a comparatively narrow range, then the redistribution problem would be greatly magnified.

RATE SUPPORT GRANT

15. LIT could complicate for the government the already complex and politically difficult process of burden equalisation via Rate Support Grant. Whether LIT was in substitution for domestic rates or supplemented them, the income tax base, though admittedly more buoyant in the long run (taking the aggregate of local authorities), would be affected by cyclical fluctuations in the level of economic activity both nationally and locally. By contrast, domestic rateable values are much more stable, being largely immune, unlike personal incomes, from the impact of these kinds of short-term fluctuations.

COMMITTEE'S SPECIFICATION

The Committee's Secretary asked for an "assessment of the impact of local income tax (LIT) on incentives, including wage demands; on the incidence of taxation and distribution of income; and on regional policy and the movement of population and industry. This assessment would need to be made on two alternative bases: first, LIT replacing and secondly, LIT replacing, say, half the RSG, with domestic rates continuing at their present level. It would also be helpful to have your comments on the differing implications of complete local discretion over the rate of LIT, local discretion subject to an overall maximum or specified range of possible rates, and local discretion subject to a limitation on the rate of change. In particular, the Committee would appreciate your comments on how LIT would differ from rates in all these respects. Finally, it was suggested that if local authorities had two significant tax bases there would be new problems of equalisation".

TABLE I
MAIN SOURCES OF CENTRAL AND LOCAL GOVERNMENT
CURRENT INCOME

1975-76 (Estimates)	£m.	% of Grand Total
<i>Central Government</i>		
Taxes on Income	16,075	40
National Insurance Contributions	6,635	16.5
Taxes on Expenditure	10,520	26.2
Rent, Interest and Dividends	485	1.2
Sub-Total	33,715	
<i>Local Government</i>		
Local Rates	4,184	10.4
Rent, Interest and Dividends	2,270	5.7
Sub-Total	6,454	
Grand Total	40,169	

Source: Financial Statement and Budget Report 1975/76.

PERSONAL TAX/DOMESTIC RATING

TABLE II

Increase in personal income tax rate required to raise same amount of revenue as domestic rating receipts for 1971/72
 Numbers: millions Amounts: £ million

	Population	Total Net Income		Net Investment Income		Schedule D - Profits and Professional Earnings		Domestic Rating	Average Personal Rate	Addition Required		Total Average Tax Rate Required	Product of IP on IT Rate	
		Nos.	Amount	Nos.	Amount	Nos.	Amount			Average Rate (a)	Standard Rate (b)			
United Kingdom .. .	55.7	21.0	35,600	4.9	2,120	1.8	2,698	954	17.9	2.68	6.13	20.58	155.6	
England .. .	46.3	17.8	30,603	4.2	1,845	1.5	2,260	807	18.0	2.64	5.88	20.64	134.9	
Wales .. .	2.7	1.0	1,517	.2	72	.1	133	1.0	37	16.3	2.44	5.83	18.74	6.2
Scotland .. .	5.2	1.7	2,786	.4	171	.1	231	1.8	99	17.0	3.55	8.46	20.55	11.7
N. Ireland .. .	1.5	.5	694	.1	32	.1	74	11	16.1	1.59	3.83	17.69	2.8	

Evidence by the Association of British Chambers of Commerce

A LOCAL INCOME TAX

1. The Association of British Chambers of Commerce welcomes and appreciates the invitation to give verbal evidence to the Committee on the subject of a local income tax (LIT). This paper has been prepared by the Association's Taxation Committee as a supplement to its evidence on this subject.
2. There appears to be an increasing tendency for government to use industry, commerce and other employers to carry out administrative functions which would otherwise have to be performed by government. The collection of tax on employment incomes was an early and remains the principal example of this. Statistics are not available to show the cost to employers of providing this service but it seems not improbable that the staffing requirements of employers must at least equal those of the Inland Revenue. Any increase in the burden of tax collection is likely to be borne as to at least one-half by employers and thus involves a hidden increase in the cost of all goods and services.
3. This burden falls more heavily on the smaller employer in the private sector where payroll preparation is performed manually or by simple accounting machines and the economies of computerisation are not available.
4. The Committee may care to refer to the Association's evidence to the Select Committee on Tax-Credit¹ where the routine of payroll preparation was described in detail as the background to a review of the administrative consequences for employers of the introduction of the Tax-Credit System.
5. It is apparent that, whatever form a local income tax may take, it must involve additional work in payroll preparation. This means an increase in non-productive overheads which will bear most heavily on small employers in the private sector and must add to the costs of all goods and services in the country.
6. It is taken as axiomatic that the taxpayer must be told what tax he is paying. Whatever method is used to calculate and collect the tax, the individual employee's payslip must show as a separate sum the amount of LIT which has been deducted from his pay. If there were to be any suggestion that this should not be done, this Association would object most strongly. In such circumstances it would be infinitely preferable on grounds of efficiency of operation

¹ Report of the Select Committee on Tax-Credit (1973) Vol. III Appendix 24 pp 48 et seq.

and of minimising the costs of collection to have a standard surcharge at a uniform national rate to provide an agreed sum which would be hypothecated from the total yield of income tax to local authorities on appropriate statistical bases.

7. It is understood that the liability to the tax would depend on the individual taxpayer's place of residence. This leads to the following questions:

- (1) The task of ascertaining every employee's place of residence and of obtaining notice of changes would lay an intolerable burden on employers. There will be many cases where employees will refuse to give the information for any of various reasons, some justifiable. In a very much greater number of cases employees will not be bothered to notify changes and, if they move to a more heavily taxed from a less heavily taxed local authority area, many will have a positive incentive not to do so.
- (2) The number of persons who move their homes in any year is understood to be between 10 per cent and 20 per cent of the total population. This presents an enormous problem in recording changes and of ascertaining whether the new address is in a different local authority and, if so, which. If some date, presumably before the beginning of the fiscal year, is taken as fixing the deemed place of residence for that year, it is not impossible that a significant percentage of the taxpayers affected will be effectively disenfranchised so far as the taxing authority is concerned. The principle of "no taxation without representation" ought still to be regarded as binding.
- (3) Some people have two places of residence. At present they pay rates in both. Will they have a double tax charge under LIT?
- (4) Some people have no fixed place of abode. Is it envisaged that they would be exempt from LIT?
- (5) The PAYE system is no more than a means of collecting tax. In a large number of cases, because of changes in personal circumstances, in other income, in charges on income, or in allowances, an adjustment has to be coded into a subsequent year to collect tax underpaid in an earlier year, or alternatively over-payments are refunded in a subsequent year. Even if an employee is regarded as being resident in one place for a whole tax year when in fact he has moved to a different local authority area, his tax deductions in the later year will be related to his later place of residence. This could result in under or over charges or allowances. If changes in place of residence are effective for tax purposes from the date of removal (which as stated in 7(1) above is desirable from the point of view of the right of the taxpayer to have a say in the election of his representatives on the taxing authority) the consequential adjustments required in a cumulative system within the tax year of tax deductions would involve enormous complications and an unacceptably heavy burden of work for both employers and the Inland Revenue.

8. It is understood further that it is contemplated that the base for LIT would be the same as for income tax. This implies that all allowances for income tax

are given for LIT and all income subject to the former is subject to the latter. This raises the following questions:

- (1) Is it accepted that the individual who pays mortgage interest pays less LIT than one who does not? Similar if perhaps less relevant questions arise in connection with other deductions and allowances.
- (2) Loss relief is given in a variety of circumstances and in some cases can be carried forward without time limit. Is this acceptable in the base for LIT?
- (3) Foreign profits, earnings and other income have peculiar bases for income tax. For example, a person may have a place of residence in this country but, if he is away on work for a whole year, his foreign earnings will in certain cases not be charged to UK income tax. In other cases only 75 per cent of such income is chargeable. Will LIT adopt the same treatment?
- (4) Individuals resident or ordinarily resident but not domiciled in this country are not charged to income tax on non-remitting foreign income. Is this accepted for LIT?
- (5) In certain cases income tax is deemed to be attributed to an individual who in fact never receives it, e.g. income from settled property deemed to be that of the settlor, apportionments of close company undistributed profits to the participators, etc. Is it suggested that LIT should be charged on such income?
- (6) Building Society interest is paid free of tax which is notionally deducted at a special composite rate. Has it been considered how LIT would apply to such interest?
- (7) In any event how is LIT to be collected on income other than that arising from employments under the PAYE system? Where there is direct assessment, e.g. on profits of trades or professions carried on by individuals alone or in partnership, a surcharge for LIT is clearly not a major problem. In the case of investment income, however, in the vast majority of cases income tax is deducted at the source by the company, paying agent, etc, and, unless the individual is subject to higher rate tax, the Inland Revenue have no further interest in it. It is clearly impracticable to require paying agents to deduct LIT at different rates dependent on the ultimate recipient taxpayer's place of abode.
- (8) A question of particular interest to this Association is the treatment of companies. If companies are not to be subject to LIT, the individual carrying on a trade or profession through a company would appear to be more favourably treated than one trading as a sole proprietor or in partnership, to the extent that profits are retained in the company and not paid out as remuneration or dividends. If, in an attempt to avoid this distortion, close companies were proposed to be treated for LIT as e.g. partnerships, not merely would the legislative provisions necessary to effect this be immensely complicated but, in addition, a further distortion would be created as between close and non-close companies.

9. It is clearly envisaged that a LIT would be levied at rates to be fixed by local

authorities. Given the spending propensities of local government, which are unfortunately all too evident, it might be assumed to be highly probable that the rates would in a fairly short time all be stabilised at whatever ceiling Parliament might feel constrained to set to protect the national revenue. However at this stage one has to assume varying rates. This has the following implications:

- (1) Every employer will have to be provided with separate tax tables for every scale of rates possible under the system.
- (2) Payroll preparation will involve the selection of the appropriate tables for each employee's taxation calculations.
- (3) The complications arising from changes of residence between local authorities are referred to in 7(5) above.
- (4) Direct assessment would be required for all investment income paid under deduction of tax.
- (5) To avoid the complications resulting from (4) consideration might be given to having a standard rate of LIT applied regardless of place of residence. This would produce still further anomalies. If a median or average rate of LIT were applied, there would be the possibility that in smaller cases unearned income could be taxed at a lower rate than earned. If the maximum rate is chosen, this would be manifestly inequitable to e.g. the retired individual living on income from personal savings, the widow living on the income from her deceased husband's estate, the thalidomide victims living on the income from their trust funds, etc.

10. The above paragraphs summarise some of the difficulties and problems which the Association envisages in relation to LIT. The problems of administration for employers generally arise in the areas of payroll preparation and personnel administration. The following paragraphs examine the implications in these areas.

11. The detailed operations which are carried out in payroll preparation to ascertain the PAYE to be deducted in any week or month are as follows:

- (1) Add gross pay for week/month to cumulative gross pay from 6 April until the last pay day.
- (2) Ascertain free pay to date by applying employee's coding to the free pay tables for the appropriate week/month.
- (3) Deduct free pay to date from gross pay to date to ascertain taxable pay to date.
- (4) Ascertain tax on taxable pay to date from tax table.
- (5) Deduct tax paid up to last preceding pay day from total tax payable to date to arrive at tax payable this week/month.
- (6) Enter tax payable in payroll deductions.

12. On the assumptions that the maximum degree of simplification possible is accepted, regardless of the inequities inherent in such a course, and that

- (a) the individual taxpayer is deemed to be resident throughout a fiscal year at his place of abode at some date in the preceding year,

- (b) the same base is adopted for LIT as for income tax,
- (c) prior year adjustments are not 'coded-in', that is they are dealt with by the Inland Revenue directly with the taxpayer, and
- (d) either charges and investment incomes are dealt with outside the PAYE system altogether, to enable a national rate of LIT to be applied in all cases, or alternatively all investment income and charges not 'coded-in' are taxed to LIT by direct assessment.

the minimum increase in the work involved in payroll preparation to ascertain the income tax and LIT to be deducted under PAYE at any payday would result in the following detailed operations:

- (1) Add gross pay for week/month to cumulative gross pay from 6 April until the last pay day.
- (2) Ascertain free pay to date by applying employee's coding to the free pay tables for the appropriate week/month.
- (3) Deduct free pay to date from gross pay to date to ascertain taxable pay to date.
- (4) Select appropriate tax tables relating to the LIT rate to be applied to the employee.
- (5) Ascertain income tax on taxable pay to date from tax table.
- (6) Ascertain LIT on taxable pay to date from tax table.
- (7) Deduct income tax paid up to the last preceding pay day from total income tax payable to date to arrive at income tax payable this week/month.
- (8) Deduct LIT paid up to the last preceding pay day from total LIT payable to date to arrive at LIT payable this week/month.
- (9) Enter income tax payable in payroll deductions.
- (10) Enter LIT payable in payroll deductions.

13. At the end of each month the employer has to remit to the Collector of Taxes the income tax collected under PAYE in the month together with the national insurance contributions for the month. The separate totals of each have to be recorded separately on a payslip provided by the Inland Revenue. There would clearly have to be a provision for LIT to be remitted similarly, which implies the necessity to ascertain a third total - the LIT collected - for recording on the payslip. It is to be hoped that the task of analysing the LIT deductions at the different rates for different local authorities would be performed by the Inland Revenue when the tax deduction cards are sent in at the end of the year (see next paragraph). If employers are to be required to provide such an analysis monthly, this would involve a substantial volume of extra work for them.

14. At the end of each fiscal year employers have to list the income tax deductions and national insurance contributions in respect of every person employed during the year and to send the list together with the tax deduction cards to the Collector of Taxes. As with the monthly returns LIT would obviously have to be included separately in the annual list. As stated in the last paragraph, any requirement to analyse the LIT as between different rates and/or local authority areas would add a large volume of extra work for employers.

15. Whenever an employee leaves, a form has to be prepared in triplicate recording the total pay, income tax deductions and national insurance contributions to date. One copy is sent to the Inspector of Taxes and the other two are handed to the employee. He must produce these to his new employer who prepares a new tax deduction card from the information recorded on the form, of which he keeps one copy and sends one to his Inspector of Taxes. The introduction of LIT will add to the work involved in all such cases.

16. There are many other matters involved in dealing with PAYE too lengthy for consideration in detail in this paper. The Committee will no doubt have studied the Employer's Guide to PAYE (P7) which is issued to all employers by the Inland Revenue and from which the extent of the various situations which have to be covered by the system can be seen. Clearly, however, LIT would produce extra work in dealing with all of them.

17. The Inland Revenue in turn have the task of checking all the various returns and tax deduction cards and any increase in the work load placed on employers will be mirrored by a similar increase for the Inland Revenue. No doubt the Committee will have obtained from the Inland Revenue their estimates of the additional staffing requirement which an LIT would produce. As stated in paragraph 2 above the Committee should assume that employers generally would be likely to have in total at least the same additional staffing requirement. It is again emphasised that this burden must inevitably fall more heavily on smaller employers.

18. It is further emphasised that the additional burden of work envisaged in paragraphs 11 to 16 above is the absolute minimum. If, in the interests of equity between taxpayers, the degree of simplification envisaged in paragraph 12 were found not to be acceptable, a further, probably substantial, additional burden of work must result both for the Inland Revenue and for employers.

19. So far as personnel administration is concerned two aspects are immediately apparent:

- (a) the possible disincentive effects of LIT, and
- (b) the work involved in dealing with employees' problems.

20. Under the present income tax system the former reduced rates of tax, which applied to incomes which just exceed the threshold of personal reliefs and allowances, have been abolished. As a result of this, as soon as the threshold is crossed, income tax is deductible from all additional earnings at (for 1975-76), 35 per cent. In addition to this there is now a further $5\frac{1}{2}$ per cent deduction for national insurance. To the uninformed employee the exact manner in which the tax is calculated is not necessarily perceived for the following reason. In the case of a male employee, married with two children under 11 and earning say £40 per week, the effective rate of tax deducted from his weekly pay is 11.7 per cent (see Financial Statement and Budget Report 1975-76, page 38). If he works overtime in a particular week (or indeed if his pay goes up for any reason such as promotion or a wage award), he finds that the increase is taxed at 35 per cent plus $5\frac{1}{2}$ per cent and he will, not unsurprisingly, regard this as excessive. If LIT is introduced that rate must inevitably rise still further. Thus

a 5 per cent LIT would produce a rate on increased earnings of 45½ per cent. Quite apart from the disincentive effect on the individual, who may feel it is more worthwhile either to take more leisure, or in many cases take on casual jobs for cash payment (although legally taxable it is doubtful whether he would go to the trouble of advising the Inland Revenue of such receipts), it is not improbable that the extra burden would be used by less responsible trade union officials and by unofficial leaders as an excuse for demanding additional pay. The implications on the 'poverty trap' area will also be considerable.

21. It is the experience of employers generally that queries about tax deductions are taken, not to the Tax Office, but to the employers' wages or personnel departments. The employee knows the people there and it does not mean a journey in leisure time to the Tax Office, which in any event may now be unable to give an immediate answer with the removal of PAYE administration in many cases to remote centres. The introduction of LIT would undoubtedly increase the volume of such enquiries and result in an extra burden on employers.

CONCLUSIONS

1. The introduction of LIT raises general problems including in particular
 - (1) those arising from the residence qualification, and
 - (2) those arising from the base of LIT in relation to income tax.
2. Simplification is in general incompatible with equity as between taxpayers.
3. Even with maximum simplification LIT would result in a substantial increase in the costs of payroll preparation and of personnel administration.
4. This increase would bear most heavily on the smaller employer.
5. LIT would almost certainly have some disincentive effect on effort by employees generally.
6. In terms of the national economy LIT would add to the costs of all goods and services.
7. The Association of British Chambers of Commerce, while sympathising with the problem facing the Committee in relation to sources of local government finance, must for the reasons set out in this memorandum strongly urge the Committee to reject LIT as a solution to that problem.

Oral Evidence by the Association of British Chambers of Commerce

14 November 1975

LOCAL INCOME TAX - POSSIBLE BURDEN ON EMPLOYERS

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ORAL EVIDENCE—ASSOCIATION OF BRITISH
CHAMBERS OF COMMERCE

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Q: Mr Marsom, may I begin by saying how pleased we are to see you here this afternoon and thank you for finding the time to come and talk to us.
-A: May I say thank you, too. I was going to introduce my colleagues, but I see you have done it for us.

Q: We have set out in a letter certain general matters which we would be extremely grateful if you would have in mind. It is the letter of the 6th November in which Mr McIntosh has given a general outline of the background to this afternoon's discussion. Perhaps I can take it just a shade further, and I think it might be worth having that letter in front of us. If I can just take it one stage further so that I can explain the context generally. As you can imagine, we have had a great many representations, not only by employers' organisations but by the lay public and everybody else, and we have explored a number of different possibilities for taxation, looking at each one with a clear and I hope as detached eye as we can, and in looking at local income tax - and I can assure you that we have formed no specific views yet - in looking at it we have been very anxious to try and assess with as great a degree of

accuracy as circumstances permit what the pros and cons would be if anybody were to introduce one. One particular area which has attracted our attention for some time now is this: it is not too difficult, I think, to form some idea of the burden which might fall on the Inland Revenue or anybody else connected with the tax, whether it is central government or local government or whatever. What we have found much more difficult to understand as well as to try and measure in a general sense is what the burden of any kind would be upon employers who have to handle this particular matter. We have in our mind tended to divide them into two, very, very loosely, because it seems to us that there are a number of employers on a very large scale, particularly those with access to computers, who though they will undoubtedly face problems and costs if a local income tax is introduced have a problem probably different in scale and character from the medium and the small companies where the problem, we suspect, may be much more acute, and much more important in terms of its impact. So while we are anxious to be told about both, it is the medium and small concerns that we feel rather worried about. What we

would very much like your aid on this afternoon therefore is helping us to understand, with some sort of sense of measurement wherever that is possible – and where it is not giving us some feel of the nature of the problem – what you think would be likely to be a cause of concern were a local income tax to be introduced.

May I add one final thing, and that is that we think that any such system, if it were to be adopted by the Government, would take quite a number of years to bring into being and in that time there would obviously have to be a lot of discussion between government and bodies like yourself, public departments, local authorities and others as to exactly what ought to be done, to put the general principles into operation. So we think that it is not feasible to talk about a scheme in a nice package sense in the way in which the Chancellor, at least in theory, would have in his mind before he introduced it. Recent experience does not suggest that in fact it is the same in practice as it is in theory.

That is the general background against which we would appreciate your aid. I am going to ask my colleague, if I may, to start our questions on the way, but before I do is there anything you would like to say generally in response to our letter before we raise some problems with you which are giving us particular trouble?

-A: May I say, thank you, Sir. We have had the benefit of a conversation which I had with Mr McIntosh in which he outlined what could be the sort of minimum case for involving the employers. We have given some consideration to that as far as it is possible to do so in the rather short time available, because we had hoped when we put our evidence in last December that the idea of a local income tax would have died along with a number of the other suggestions which were in the Green Paper which so admirably spelt out most of the difficulties. We have prepared a paper which we have brought along with us which might assist you in that we have particularly gone into the nature of the detailed steps that a

medium sized and a small sized employer would have to take.

Q: Could we see that?

-A: We would be very pleased to give you copies. We have brought about ten with us. It does get right down into the nitty gritty of what the employer is actually doing. Could I say that if we perhaps had adequate transport we would have brought with us a full set of the Inland Revenue tables and things that are necessary in preparing a payroll!

Q: If it is of any help to you, I should say we have seen what we believe to be all the relevant forms and tables, and we have been to the Revenue offices to see exactly what happens in practice. I think we have a fair idea from them now of the problems you report to them. They tell us very clearly, or they have been at pains I should say to warn us at every stage, that there is an employer's end to this and they think we should know about this. Everything that can be told us from their end about your problems has already been mentioned by them.

-A: You will have discovered that the income tax system is really designed to do things quite different from collecting a tax based on where people live. I found when enquiring amongst my own company and this has been borne out by most of us, that on the whole the employer himself does not necessarily need to know where his employees live. In fact, there are many instances where they would not want to tell him. He needs to know their bank accounts or where they would be on a particular day for pay purposes and where they normally work. He may need to know a place to which he can post things which will reach them, but on the whole an up-to-date list of addresses is not an essential management tool.

Q: Yes. The Inland Revenue took a lot of trouble when they first saw us a good many months ago to make the distinction between tax systems based on place of residence or the other which

is based on place of work. It was not only very clear to us then, but we have spent a lot of time at tax offices having a look at the problems about residences and so on. We fully appreciate them.

-A: Could I say also that the task of getting a possible scheme or almost any scheme off the ground which involves a link between the payroll and residence would be a very sizeable one and a great deal of the work we think could easily fall on employers however much the Revenue might volunteer to take it on themselves.

Q: May we just pause there and read your memorandum. [Same handed]

-A: I am Chairman of the Taxation Committee of the ABCC and I was largely responsible for the drafting of this. It is fairly lengthy and patently we cannot go through it all at this moment, but I could take you to particular points. If we start off with paragraph 6, which we think is important, that in fact the tax must be perceptible, we would regard it as absolutely essential, and we have taken it as a principle in looking at the implications for payroll preparation, that the employee must know what the deduction is, that we would not regard it as acceptable that there was just a deduction for tax, full stop. If that were regarded as the way of doing it, then we fail to see any need to do anything more than have a national surcharge which is then farmed out amongst local authorities, or hypothecated. The employee must be capable of detecting what he is paying for local government, because the essence of the thing surely is no taxation without representation, and if the employee cannot see what his local authority is charging, then how the devil can he be expected to exercise his rights as a citizen living in that authority.

Q: You may take it we accept that.

Q: Accepting the point, it does not necessarily have to be done, does it, on the pay slip week by week; as long as it is conveyed to the employee in a sufficiently emphatic form at sufficiently

frequent intervals so that he is not under any misapprehension about what tax he is paying for what purposes, that would be sufficient.

-A: What would you regard as sufficiently frequent?

Q: The least frequent one could think about would be once a year, that is to say, when he is told at the beginning of the year what his coding is, or again perhaps at the end of the year how much he has in fact paid.

-A: Let us consider that one. If we are to assume that the tax is to be based on residence, which we take it is the basic assumption from what we have been told, that residence has got to be ascertained before the beginning of the tax year, and the odds are that bearing in mind what we know of the Revenue's methods of operating, you are likely to be talking about a period probably as much as a year or even longer before the beginning of the fiscal year. You then have the situation that assuming it was once a year it could only be after the end of the fiscal year. Now we have referred in the section on residence, and the problems that arise from that, to the fact that you could, given the propensity of the population to move, find a situation where perhaps over a two-year period by the time they have got that information they are no longer in a position to do anything about it because it does not concern them any more, they are not living in that local authority.

Q: I am anxious not to get too far away from those points that you can help us with but do not let us part from that without saying I think that makes a lot of assumptions which are not necessarily right. First of all, it does not follow that because people move they are moving out of the local authority area. There are quite a lot of ifs and buts about that.

-A: Returning to the point that your colleague raised I think it is absolutely essential that employees know at all times what their deductions are and what they relate to. You do not deduct

National Health Insurance and tell them what it is once a year. You tell them week by week or month by month.

-A: I am fairly certain it must be illegal not to do so, but I could not put chapter and verse on it.

-A: From a practical point of view too, it is probably more convenient to do it then if you are going to do it at all. I represent a large employer and it has got to be done on the computer, and I would have thought so with most employers.

Q: When I was employed, my employer, who was a Government Department, used to deduct monthly from my pay a thing called consolidated deductions which amounted to a considerable sum of money, and once a year they sent me a statement which said "These consolidated deductions are as follows", and I found that entirely satisfactory.

-A: I do not think the weekly paid chap would find it so satisfactory.

-A: Can I just draw a distinction. The whole of your deductions by and large, the person who was answerable was the chap you voted for at Parliamentary elections. It did not matter what they were, because one way and another he had a hand in the whole lot, which is not the case on a local income tax.

Q: You were going to take us through?

-A: Could I just say that I am fairly certain that the unanimous view of all employers would be that they would have to show every deduction of LIT just as much as we show every other deduction today.

Q: I think we would be very reluctant to make any absolutely categoric assumptions about a tax where there is no legislation yet in being. I take your point that it is important that it should be done frequently.

-A: We are in an era of, I will not say rule by consent, but certainly rule by the best available practice. There are any number of guides as to the right sort of practice and this I am certain an employer would want to incorporate in

such a guide, whether it were legal or not.

Q: Whether that would be so in three or four years' time when we had got the shape of the tax would I think be another matter, but I entirely take the point that it is important that they should fully understand at whatever turns out to be the right interval what it is they are being asked to pay.

Q: Could I ask, I was not quite clear whether you were thinking our visitors would identify all the points and then come back.

Q: I was just looking through the first page. It seems to me there are a number of critical points about what the employer has to do, not what he does not have to do.

-A: Effectively one raised the questions because unless one knows what the employer has to do and what the form is, you know, it depends on that what the employer has to do.

Q: I quite accept that. There are some features which can be taken which are things that we know would have to be done. What would help us in the first place is to identify those and then by all means return to things that are more problematical.

-A: Given the assumption that the Revenue is responsible for finding out where people live; if we can take that one for the moment which is the maximum simplification from the employer's point of view, the employer is not concerned with where his employees live. If we can take that assumption, we can miss out in 7 relating to residence everything except the last section (5), because the point arises there that if an employee has moved under the PAYE system adjustments are made in later years for corrections in earlier years. Now if you are taking the same situation, it is likely that the Revenue are going to have to instruct the employer in some way. If they code in an underpayment in year 1 and the chap in year 2

lives in a different local authority area, which has a different rate of tax, how the devil is that adjustment which ought to be made at the earlier rate of tax made when he is being taxed on tax tables at a second rate of tax. This is one which it would appear could well be laid on the employer and enormously complicate his problems. Have I explained that clearly enough?

Q: Yes, I follow that.

Q: Coding in earlier years' adjustments, where there has been a change of residence between the two years.

-A: This of course - where you have a national tax - does not matter where it is the same rate of tax. Bearing in mind, all right, that 10 to 20 per cent move every year, all right, so only half of them move from one local authority area to another, it is still a pretty sizeable problem, given the time-spans we are working to. There are two implications of this. First of all, let us take the computerised payroll. In that case the programme has to be written to allow for this. In the case of the smaller employer, the staff who are engaged on this what you might call semi-skilled clerical work - I think it is the general experience - are not that easy to obtain, you have got to train them up, and to add yet another complication to the burdens placed upon them it seems to me could well lead to a multiplication of error and trouble. So if we could make that point. That I think is the only one at this stage, as I say, on the assumption that the Revenue are dealing with the addresses. There is the question of the chap who has not got a place of residence.

Q: There are problems about residence but let us leave it on the assumption that they will not be employers' problems.

-A: Then the question arises on the base which may affect it and can have an effect on employers, all sorts of things, and we have listed some of them that occur to us. There is the chap who works part-time overseas. What about

building society interest and its composite rate? All these sort of complications, and we have listed a whole number of them, some of which may affect employment.

-A: One important one we would like to add to the list is alimony, which we have not included here specifically.

-A: It is actually maintenance after the divorce!

Q: Could we identify possibly which of these is of particular concern to the employer. I can see that there are bothers about all of these things. What I find it less easy to see is which of them would give bother to the employer as distinct from bother to the Inland Revenue.

-A: And to the taxpayer generally.

-A: Perhaps I can mention one particular one which might involve the employer. Take an expatriate of a British company who is working abroad and let us assume that in the circumstances his income is entirely tax free. He might conceivably be paid by the UK source. He may well have left his wife and family behind living at home just like anybody else, and it might be deemed by Parliament that as a drawer on local services there ought to be a payment made. You could then get an intervention into the paying system which might be outside the normal tax structure. That is one.

-A: I think the major one for the employer is the treatment of income and charges other than those arising in the employment as part of the PAYE system.

Q: Like bank interest.

-A: And this leads us on to how you deal with dividends and all those sort of things because the one depends upon the other. You can either code-in, in which case it seems that you would have inevitably to have a form of direct assessment on income that does not come within the PAYE system, or if you are going to have a possible solution of a flat rate on investment income, then you have all sorts of anomalies because if there is a flat rate then you

have inequities, or if not inequities anomalies, as between individual A and individual B.

Q: I think we see that, but I am not quite sure what the employer's problem is there.

-A: The employer's problem that would arise, it seems to me, depends upon the solution that is adopted, because if the solution has to be some form of adjustment coded-in in some way, an adjustment on coding-in or something with special tables, is extra work for the employer. That is why we raised this question that you cannot just ignore individuals.

Q: Individuals are a difficult and different matter.

-A: But a lot of people in employment have unearned income and have charges on their income.

Q: I quite follow that. What I am anxious to be sure is where is the employer's problem, not what are the drawbacks and difficulties of the system as such.

-A: The employer's problems will arise if some special procedure has to be adopted as it would seem it would have to be to deal with the anomalous case. We have mentioned the man who is paying maintenance. It may well be coded-out.

Q: I follow that one.

-A: It may well be coded-in.

Q: I follow the general coding-in point. I am anxious not to duplicate points. We will take your point about maintenance and I see what you are saying about coding-in.

-A: What we envisage is you may well find you are having to have special supplementary tables, in addition to however many local tax tables, as for example you have at the moment for a person who is earning more than so much, you get higher rates, and you may have to have supplementary tables yet again to deal with anomalies. If that is the case, that increases the burden on employers.

-A: Or it could be in the form of a supplementary code number, such as one code number for income tax which deals with the all the prior year's adjustments and then a special code number for LIT work, which is purely current.

Q: I follow that.

-A: Which must mean extra work. In administrative terms this also follows on, there would have to be separate tax tables and so on. I think we then come down to 11 where we really get down to the nuts and bolts. We spell out there

-I apologise it is over-simple – basically the operations that must be done whether by computer or by somebody pushing a pen or by a machine in dealing with PAYE as it now exists. No doubt you are aware of these steps that we have gone through. I do not think we need perhaps to go through them one by one, but those are the logical steps, and it does not matter whether you do them by computer or whether you do them by pen and ink; they have to be done; that is the load. Now we have made certain assumptions as to the maximum degree of simplification, to arrive at what the load would be under LIT. We have assumed the individual taxpayer is deemed not to move in a year. That is the first one. We have assumed you adopt exactly the same base regardless of anomalous situations. We have assumed that prior year adjustments are not coded-in. In other words, you thrust upon the Revenue a horrible problem of dealing with the prior year adjustments outside the PAYE system, and have assumed that the question of charges and investment income is either left right out of the system or alternatively that you deal with them by direct assessment on LIT and that is a big assumption. But just assuming that, which seems to take all the bugs that you possibly could out of the system, you then find where before you had six steps we cannot see that there can be less than ten steps, or ten operations.

Q: Can we distinguish which is which?

-A: The first three are exactly the same.

You have to take the gross pay, you add it to the pay for last week or last month and you get your accumulation. You ascertain the free pay, with the basis the same, deduct that from the gross pay, and you then have got the taxable pay. You have then, instead of just having a standard table, got to pick a special table which is an extra operation. You have to ascertain the income tax first of all on the taxable pay to date and you have to ascertain the LIT on taxable pay to date from the tax table. You then have to deduct the income tax. . . .

Q: (6) is the additional one?

-A: (6) is an additional one, (8) is an additional one; (4) is the first additional one, then we have (6), then (8) and then we have (10), and those it seems to us are inescapable additional extra operations which have to be carried out, whatever the system. Now the implications of those are fairly simple. Starting at the one end, of a computer, it means programming and it may well be that people are in a situation that my colleague's company found itself in a year or two ago when they found their computer had not got a big enough memory to deal with it and they had to buy a new computer. That can be first thing.

-A: We wanted it for other reasons, but that was one of the many features that was apparent, that the payroll work had expanded so enormously; even the electronic apparatus was not able to cope.

-A: Now if you come down, probably the worst effect of them all is for the person who is dealing with it on what we know as keyboard machines because these in fact work with registers which are a series of little taximeters in the machine. Most keyboard machines have been extended in size in recent years, and they have more registers but the effect of doing this is that you would have to expand them very enormously, and almost certainly probably 90 per cent at least of the machines currently employed on payroll preparation would have to be scrapped. You would have to have more machinery because of the

need for extra registers. This is an inescapable thing, which might be very nice for Burroughs and people like that but on the other hand it is not very nice for employers generally. Then of course you come down to the chap who is doing it with pen and ink. Well, basically it is a simple function of time, but whereas before there were six operations now there are ten. Now we have not sat down with a stopwatch and clocked how long each operation takes, but effectively it is obvious through sheer simple logic that if you have got to do ten operations it must take more time than six. What it means in terms of staff for the individual employer depends on the size of the operation. We personally, where I employ two staff, I shall not employ anybody extra. I shall still do it myself but more of my very valuable chargeable time will be lost on administration. For the chap who has one person doing payroll, he may feel it may be the thing that makes him double his payroll force. For the person with 10 they might need two or three - who knows? It depends; it is a function of size. But it is an inescapable consequence it seems to us of this.

-A: Could I add that a large company has estimated that the extra initial work programming this on a computer would amount to the equivalent of one man for four months. This is working very hypothetically but assuming a sort of minimum burden scheme for the employer.

Q: Just to get some idea, what that means, how many employees would that be accounting for?

-A: 24,000.

-A: It would be the same cost doing a payroll of 1,500.

-A: The programme is going to be the same for the employer of 500 or 5,000.

Q: But once I have gone up above that - all right I am 5,000 up - does there not come a point where there is a step?

-A: No, the programme is the same. The only thing is then the amount of computer time. It may well be that for

the time the computer was engaged on payroll you might have to drop something else.

-A: I would not rule out the possibility of certain large companies having a number of independent payrolls perhaps with different types of computers because one does not instantly scrap everything on a single date. Computers have been with us now for 10 or 20 years, so there could be a doubling up at some stage, depending on the nature of the business, the number of employees at any one point, and its accounting operation.

Q: These 10 operations—I am just making sure I understand the assumption—do assume that you disaggregate the national tax and the local income tax throughout.

-A: We would say that we regard it as axiomatic that that must be so.

Q: I do understand that, but it is an assumption?

-A: Yes.

Q: If one were making the other assumption, that one could aggregate, then you would cut out several steps.

-A: Oh, if you simply said that there was one deduction, then it seems to me one standard rate of tax regardless of what were the components of it, you are back to the present PAYE system, and then you have not got a local income tax any more.

-A: You have hypothecation then of national revenue.

Q: There is some resting place between these two it seems. One could contemplate that one would have LIT at variable rates and not disaggregate the national and local income tax week by week. I mean, that is a possible sort of conception.

-A: Yes, it is.

Q: In which case you would not have a hypothecated tax but a true local income tax. You would have the problem of making it perceptible. It is important and I accept it is important. But you would not, unless you were making

it perceptible week by week—and I do understand you say you think that is important; but could we just for the moment put that on one side—three of these steps are concerned entirely with the objective of making this perceptible week by week for the employee.

-A: Yes. There is just one thing, that any time span other than a year would not make all that much difference except for the fact that the extra work would be required at periodic intervals. As I say, we regarded it as absolutely axiomatic because if you are not going to make it really perceptible then why bother? Why not simply have a surcharge on income tax?

-A: I think the point perhaps ought to be made that if you have got to make it perceptible at some time, it is easier on a computer to do it all the time.

-A: Can I just come down to one other practical point. Supposing you are going to tell the individual annually, well, every week the chap gets a pay slip which shows the pay and the deductions. At the end of the year, the employer is required to hand to the employee a piece of paper which shows his total pay and his total tax deductions and so on, and I imagine that the amount of attention paid to that is fairly inconsiderable because he does not get any money with it. All it is is an official form. It is something that is with his money that is the significant document.

Q: Could I go back to a point you made a moment or two ago. I think I know the answer to it but I should like to be quite clear. You were saying there was no half way house where computers were involved, in disaggregation once a year or once a week. Why is that?

-A: There is, inasmuch as you then have to set up a complete year-end operation to sort the thing out. It would not be worth it. You would probably have to do it by manual intervention.

-A: You would have to set up the programme to pick up the information at some time or other.

Q: I mean, suppose you do it every quarter.

-A: There is little point. Having written your programme you might as well use it. You have got to write your programme. So having written it, for the benefit of the employees, use it all the time.

-A: It would mean an extra programme.

-A: You see, there are many times through the year where you have to give the employee a full statement because he is leaving. One always knows in advance when an employee is leaving.

-A: That is not always true!

-A: It could be one hour in advance, but you do have to take account of a quite considerable movement of staff, and you could not easily have one law for the leaver and one law for everybody else. One wants a standard programme to adopt at every paying time, monthly or weekly as the case may be, because there are other things on a pay slip apart from tax. You could not comfortably show details for everything but tax because you would then have to aggregate it at some time and that then would become misleading information.

-A: That paragraph deals entirely with the weekly/monthly thing. We then move on to the month-end operations which is the next thing that is affected. At the end of each month, as you know, there has to be a remittance to the Collector of Taxes. Now if you assume that that remittance merely has to show the total LIT as well as national tax, that is an increase of 50 per cent in the work. If it has got to be analysed as between, say, up to 10 different LIT rates, then there is a much greater increase in the work. If it has got to be analysed as between local authority areas by means of coding or something or other, then the month-end work would become quite enormous compared with the present work. This is inescapable.

Q: So from your point of view, the best thing would be for you to do as you do at the moment and deal in aggregates with the Collector of Taxes, and let him sort it out.

-A: Well, he cannot sort it out unless you tell him at least how much the LIT was, or at least the only chance he will

have to sort it out is the end of the year.

-A: You do not deal in aggregates anyway with the Collector, do you, because you disclose separately your National Health Insurance.

-A: You already disclose that. I find it difficult to believe that the Revenue would be happy not to have the figures monthly at least of the total of local income tax. I think they would find it irresistible not to demand it at least by rates and possibly by local authority areas. You know, we have said in paragraph 1 a thing of which we are very conscious and on which we had a big row with the Tax Credit Study Group when tax credits were proposed; it is fine, you produce a Green Paper which shows that you are going to save X thousand public servants and you are going to increase by 2X the number of private sector servants, up with which we will not put — or words to that effect. This is the thing we are envisaging here, simply at the end of the year you get the further consequential thing, with the annual list of all the employees, with the income tax, the national insurance and also the LIT presumably.

-A: You did mention ahead of the meeting, or Mr McIntosh did, the possibility that we might as employers be required to do no more than aggregate the individual rates. We cannot see in any meaningful system any point in producing less information than the amount deducted under the 3, 4, 5, 6 per cent rates or whatever one is talking about.

-A: Which would greatly increase the month-end work.

-A: May I also say, again one of the breaking points that might stretch a computer's memory. It requires extra time and the storage capacity, and I do not think one should overlook this because not everybody has the very latest. In fact I suppose it is more correct to say nobody has the very latest.

-A: And in terms of keyboard machines it would be quite impossible. Of that there is no shadow of doubt. It would have to be done as a separate operation, analysing the figures for individuals whatever means you use to do

it. In the case of the chap with pen and ink, with a piece of paper with columns and putting the things into it, and then adding them up to arrive at his totals, there would be no other way to do it.

-A: May I also add that even large companies with fully computerised payrolls frequently find that with the complexity of modern business it is necessary to run a series of manual payrolls for certain activities which for management purposes are best hived out of the main stream of business activity. You have a large manufacturing company perhaps running a few retail shops, where it does not want to centralise the management control. So there they will function as though they were a business employing perhaps 200 staff, or even 25.

-A: We have then gone on to look at just one of the many variations, the employee leaving, and hopefully then also joining somewhere else. This is not always true these days alas, and that again must inevitably mean that the work involved when an employee leaves in preparing a form which he then takes to his new employer, that too has got an added function on it. We have just mentioned that one, and no doubt you have looked at the things the Revenue put in their marvellous little grey book, B.7, and really on every one of those you must say and recognise that LIT means extra work. We have said—I am just repeating a point made earlier—we have no idea and I am certain that nobody has any idea of the cost in terms of staffing requirements of administering the employer's side of PAYE. The Revenue obviously know how many people they employ but nobody knows how many are employed in private industry. Various attempts have been made to make an estimate, and I think all one can gather is that we are talking about one for one or thereabouts. It seems to us that it is not an unfair assumption, even allowing for the fact that, all right, the Revenue have the residence problem on their plates—assuming that they have—with all the disadvantages of that from the point of view of taxation without representation,

and so on and so forth, assuming for the moment that that is accepted, as an unfortunate consequence of the system, that, all right, a person is going to be deemed to be resident where he was two years ago, the work that would be added to employers in other areas would increase and we think it is not unfair to say whatever the Revenue say they would need in extra staff you must in fairness assume an equal number in private industry one way or another, and in particular more in the small and medium sized employer, not the very small. The very small is me, and all you are doing is robbing me of chargeable time in which I cannot earn fees, which you may regard as my worry because I pay tax on them. But anybody who employs staff to prepare payroll, beyond the very smallest where, all right, one person can also do it, must have extra costs. We think you can say one for one, and for lack of a better rule of thumb it is a fair estimate to take.

-A: This increased burden is not if you like entirely at the clerk level because every time there is a column on a pay slip for a deduction it gives rise to queries which tend to go to the manager. It is an overall spin-off we are coming to later.

-A: We then turn to the other aspects of it for employers. One is the possible disincentive effect which you may well have looked at. For example, the individual, under the present tax system, who thinks he is being taxed at 10 per cent because that is what it looks like and then gets an increase in pay or works overtime and suddenly finds he is paying 40½ per cent with the new national insurance arrangements and is suddenly going to find he is going to pay 45½, you name it. This produces an effect for the employer because if the employer wants more effort out of his employees he may find it harder to get it. That is one of those philosophical things. But more important is the one of the work involved in dealing with employees' problems. The theory is that people with problems on taxes go to the tax office. In practice they do not, they go to their employer, for fairly obvious

reasons. First of all, to go to the tax office you have to do it in your own time. Secondly, the tax office nowadays probably cannot help you because your tax is dealt with in Bootle or somewhere like that, and so all you can do is go and see your friendly local tax office and they say, "Well, that's terribly interesting; don't write us, we'll write you", and you wait for them to sort it out maybe. So you do not, you go to the wages office or the personnel department or, in the very small business, the boss and say, "What the hell?" Effectively if you have another tax or surcharge of tax inevitably it seems the problems will multiply, and so there is that entirely unquantifiable but nevertheless real extra burden for employers. I cannot put a number on it, nobody can put a number on it, but it is there. So I think that it is in very broad outline, and we have summarised our conclusions at the end in seven short heads.

Q: Can we pause for the moment and look at the coding problem.

-A: The base of the tax we talk about in 8 and 9.

Q: We find that the usual mode of dealing with coding-in is that for some reason or another an under- or over-payment is determined for an earlier period, and that the usual process therefore is to take that amount, divide it by what you think is the marginal rate of the individual concerned, and Bob's your Uncle, you know how much extra coding reference to apply to his tax.

-A: Could I say that it is usually under-payments. Over-payments are usually repaid at the time when the cancellation is made.

Q: Usually under-payments are collected by dividing the gross sum required by the marginal rate of tax. We are not altogether clear why this would create new problems, if there were a series of marginal rates to be applied to different individuals. If the gross sum were known is there any new problem other than choosing which rate?

-A: In effect, it has pushed the indi-

vidual into a higher tax bracket.

-A: But it is more than that.

-A: And it does it by reducing his personal tax-free allowances, and therefore you would increase his LIT.

-A: There are two problems on this. One is if what you are coding is a non-employment source of income which is frequently coded-in, that is one problem, in other words, investment income or whatever it may be, bank interest. The other one is where you code-in for last year and last year the chap lives in, say, Islington and this year he lives in Stratford-on-Avon, and they have different rates of tax.

Q: But in either case a gross sum of money is required which is therefore determined by changing the coding determined by dividing the sum required by the appropriate marginal rate.

-A: Yes, but the point is that the chap is paying tax. It would be much more complicated for the Revenue to do it; they could do it undoubtedly. This presumes that you divorce entirely the payments this year from where they are going to.

Q: That is another matter altogether.

Q: Can we try and keep these things separate here. There is the question of disincentive; that is separate. Then separately from that there is the question of whether you produce an acceptable result in the amount of rates. Then thirdly, whether you create additional work at the employers' end in coding in these kind of changes. Now could we just for a moment be quite clear where we stand on the third which is what the paragraph was about.

-A: There are two aspects of this. One is the employee query. It is complicated enough now and this probably I think, as much as anything, causes queries in the personnel department and wages department when the chap suddenly gets a notice through the post in a buff envelope which he does not understand so he throws it in the fire. Next week, next month, whenever, he suddenly finds that his tax has gone up, and then somebody

has to sit down and say, "Well, look, we have been advised of a new coding." "Why?" "You should have had a form from the Revenue" and he has not got it, and this is where there are queries. That is the one aspect.

Q: So that is the query one.

-A: That is what we call a personnel administration problem. The other one arises from this: you have given us the simplest possible solution, one where the Revenue sit down with their calculators and say, "Ah, well, he's now on local authority rate so-and-so and he was on that, and therefore you gross it up and out comes the right answer in the coding for this year." That is ok up to a point, but even this does not always work and that is why the Revenue have their Week 1 and Month 1 system, which I have no doubt they have explained to you. The thing that we are concerned about is the possibility, to put it no higher, that there would be even further complications brought into the PAYE system to deal with the further anomalies that arise so that you might have special supplementary tables or something or other to deal with peculiar situations.

Q: Do you have in mind specific things which you can already see would create complications, or just a fear?

-A: The feeling that they could arise because of having differential rates of tax trying to be dealt with on one combined system.

-A: Could it not lead to a chap actually paying two rates of LIT which means he has probably got three code numbers, in other words, an adjustment of one residential area to another. He is now being taxed at Stratford when his arrears arose in Islington, say, at 5 per cent as against 4½ in Stratford.

-A: That can be dealt with by arithmetic.

Q: The difficulty is to keep one strand going at a time.

-A: It is really a fear that there could be. This thing is full of dealing with the weird and wonderful situations,

and I unfortunately have occasion to look into it and I must confess I found it terribly difficult to understand, and all one can fear is that there could be anomalous situations come up which would involve additional special procedures for employers, and this costs money. It is as vague as that I am afraid.

Q: That is all right, I am not anxious to identify them. So what you are saying is on the coding-in system, on the question of extra work involved – labour in the actual sense of the word – there are two points, one that it leads to increases in queries because a chap does not understand why something coming up later is reducing his pay by increasing his deductions. Then, secondly, an anxiety that it might lead at some stage to complications causing the production of supplementary tables.

-A: It is more than an anxiety I think, probably a well-founded anxiety from bitter past experience.

-A: Can I add a point here. It would arise I think if a coding-in, for example, reflected a different year and we were required to highlight the effect on LIT in any way of this particular coding-in. If it was just absorbed and dealt with in a mathematical way it would be fine, but if the coding-in required that the effect on LIT was to be shown then I think this would cause problems.

-A: If you had to depart from the normal tax base for the purposes of LIT then one has effectively doubled the complete system.

-A: Indeed, this pay deduction represents £5.53 for Islington less 3p you overpaid in Stratford last year. In all fairness, you know, that is what it might be.

-A: I think though to answer the point you were putting a little earlier, under payments coded-in probably even themselves out, subject to variations in LIT rates. It is conceivable even that the individual might gain because he might have a taxable income of, let us say £6,000 – move it out of the lower rate – in one authority area which would produce an under-payment; next year his

income is £7,000; if the under-payment were based on pay of £500 at £5,000 it might only need £400 at £7,000 to put that right, so I think in those circumstances - I have not worked this out - there would be a gain to him of paying less LIT.

Q: We or the Inland Revenue or yourselves would have in mind that each individual would be caught up with precision. What I have in mind is that there would be slack in the system whereby happening to go from one place to another could lead to a bonus.

-A: I was not thinking so much of how things would go. I was merely thinking that the effect of coding-in might be to reduce his taxable pay because he was moving to a higher rate by rather less than would have been the case had he stayed at the same lower rate of tax, and so therefore there would be a saving of LIT in Year 2.

-A: The Revenue will have problems with the use of accommodation addresses in suitable authorities.

-A: We would like to come back to the question of residence at some stage.

Q: Yes, well, I am just trying to clear this point. The coding-in point is rather a central one.

Q: Was your other point on coding - I just did not understand it - that it would complicate the codes themselves? You would get more?

-A: We think that it is highly probable that as a result of experience we would find that in order to get rid of the problems you would have to have more complicated procedures, which inevitably result in more work. I have only been thinking about this for a week. I dare say I could produce you a nice example of something which would be quite insoluble under the coding-in system which inevitably, Revenue officials being Revenue officials, somebody would find a solution to, and the odds are from experience that that solution is going to be worked out by the employer.

-A: This would be particularly relevant in the first year.

Q: There is obviously a transitional problem, yes.

Q: May we go back then to the central points made and see whether there is anything we want to ask you about. Is there anything you have left out about points raised about such questions as maintenance and overseas matters which are all set out in paragraph 8? It seems to me from the answers you have given to us that there are really two aspects to this. If the local income tax is wholly assimilated into the national income tax system, most of the points in paragraph 8 are ones which would be common factors in terms of amount of deduction whether you are left with wholly a national income tax or also local income tax, with the exception of the two points you have just made.

-A: Yes, I think that is so. We were looking in many cases at the effect of using the tax base itself, which is slightly different from the employer's point of view. I do not think it would matter to the employer if the national base were used wholeheartedly. It is when you get a divergence perhaps to make corrections that we would be involved. If the national income tax base were used throughout, then the problems referred to in this paper are ones where we might get complaints from employees rather than have procedural difficulties in applying the rules.

Q: That is why I say your two main points, provided the base is strictly followed. There would be a very strong incentive to do that from the national Exchequer as well as everybody else.

-A: Take the people with two houses, for example, one house somewhere in the Midlands or London area, and another house in the West Country or in the north of Scotland.

Q: That is not a paragraph 8 point. Paragraph 8 points are central to the matter. Have I got this right: provided the system is assimilated totally into the

national base, then the problems arising under paragraph 8 really include the two points you have just made; they tend to lead to more queries, and secondly that you have an anxiety that they might lead in some way to supplementary tables.

-A: Yes, particularly arising from the treatment of investment income and charges on income.

-A: And this completely disregards any other responsibilities of an employer. We are looking upon him as a payer of wages. In respect of dividends and other things it is quite a different matter.

Q: Just before I leave that, what I am not quite sure about is this; in terms of additional queries, again will the volume of queries be any different in respect of the matters raised in paragraph 8 because there is an LIT in the system?

-A: Oh, yes, I think so, inevitably.

Q: Why do you say that? Maintenance, for example, which you mentioned, why should the fact that there are deductions made for maintenance lead to a query in a system wholly assimilated in the national income tax, (a) where there is only national income tax and (b) where there is LIT?

-A: Because every time somebody moves his deduction alters.

Q: But it is not going to be different because of LIT.

-A: It depends on what happens with the treatment of investment income for local income tax. It depends how you levy LIT on investment income. If LIT is to depend on residence then the recipient of the income is going to be taxed at a different rate depending on where the recipient is.

Q: Provided investment income is taxed at the same level then so far as that is concerned that would remove that problem.

-A: True.

Q: So one has to see what is to be done about that. In what other way

would there be any difference in the queries?

-A: I do not think it involves the employer, but if you had a deduction situation where husband lived in one area and ex-wife lived in another, and if husband was required to be accountable for LIT, this would not be a problem to the employer but would be a very difficult one for the Revenue and for the individuals concerned.

Q: We are quite clear then that the only one that would lead to queries above those generated by the national income tax system under the items in paragraph 8 is the matter of investment income and cognate things.

-A: Yes.

Q: Now you said as well as paragraph 8 there was one other thing.

-A: There is this question of the peculiarities that arise in the tax system some of which whenever the Revenue get a chance to code a thing in to an employee they do, and very sensibly and you get all sorts of peculiar things which arise under the tax codes, where you get income of a settlor, this sort of thing. It is not altogether unknown to get all sorts of weird and wonderful things to happen. You see, if you look at the base qua base—and this is not particularly an employer problem as such—what happens about the case where a chap is deemed for tax purposes to have income which he does not in fact have?

Q: That is not an employer problem. There are enough difficulties in this anyway.

-A: It is not an employer problem but nevertheless it could come back if the Revenue should seek to use the coding-in; it would seem to me that there would be areas in which they can now use that system which they could not if you had a LIT, with whatever problems that raises. But it is not an employer's problem, it is a Revenue problem.

Q: It would alleviate the employer's

problems if the Revenue were as a result of introducing LIT obliged to collect directly instead of coding-in. It would be a bonus for you.

-A: Yes, but Norman Price and his boys would not agree with you!

Q: No, I agree, and I am not saying that is necessarily the solution, but if it should turn out that way there would be some help for you.

Q: Does that sort of remark again only arise if there is a different treatment of taxable income between the national tax and the local tax?

-A: Yes.

Q: If the Inland Revenue decides to code something in for national tax purposes, if we do assume the same base then does any problem arise?

-A: Assuming that local income tax applies equally to all sorts of income at differential rates.

Q: Yes, if we make that assumption.

-A: You would have some problems in other areas, I should have thought, which would have been enormous. What about the company, not as an employer but as a payer of dividends?

Q: At the employer level there is no problem.

-A: No, but speaking as an employers' organisation we are appalled at the thought.

Q: Now again I just want to clear my mind. We have had a look at 8 and on what it depends, the assumptions on which the points are made. Was there any other paragraph which you regard as of central importance and which we ought particularly to look at? I am not meaning to imply in any way that I do not regard the other factors as ones to be looked at with great care.

-A: No, I think unless anybody else has any particular points, strictly from an employer administration point of view, these are the ones. There is carrying on business.

Q: Did you want to say something on residence?

-A: Yes, I did, because this is a job which would have to be undertaken; maybe the Revenue could take it on but there is a more than strong likelihood of an employer intervention. As will have been explained to you, what happens at the moment for the small employers is that towards the year end the Revenue issues tax tables and tax deduction cards and code numbers for all the staff. The larger employers with computerised payroll frequently, say, in the middle of January send a list of all their employees to the tax office, just the names with perhaps the reference number, works number or something of that sort, employee number, and back comes a list of all the code numbers written on that very same piece of paper. Nowhere does the individual's private address occur. So that if the Revenue undertook the task of ascertaining not only private residences but local authority areas to whom they paid their rates, it could involve the employer because the Revenue would have to start work many, many months ahead of the due date, because they would have to give the employee his new code number perhaps with a local authority suffix on it at the same time as they do now, in January. They would therefore have to start work perhaps Easter the previous year finding out exactly who the employees were and where they lived. If they write to the employer and say "Who are your employees?" most employers with a computer can automatically run off a list of the staff in fact. It may be printed but it would not be a difficult job. Many of those staff may be unknown to the Revenue and they would then want to know where they can be got hold of. This is where you start the chicken and egg sequence to find out who lives where. It is a point that does need quite a lot of research in detail and we really have not had a chance of doing it.

-A: There is one possible consequence of this to the employer, that the Revenue are bound to be constrained in cases to use the equivalent of the

E coding where they are unable to ascertain the individual's address, and the Revenue being the Revenue it is inevitable that the E coding will be at the highest possible rate, which again is going to come and bounce back again on the employer, because the chap who throws his envelopes marked "Official Paid" in the fire never even remembers he has had them, and he comes along bellyaching like mad and says "Well, I shouldn't be paying this" and again it is the employer who gets it, it is not the Revenue.

-A: May I say that my own company has had quite a lot of experience of sending letters out to members of the public asking sometimes relatively simple questions and some of them are our customers. Roughly we would get back 50 per cent first time, rising to perhaps 70 per cent on a reminder, leaving the remaining 30 per cent to be followed up with some effort. I would not think that the Inland Revenue if it were searching for addresses and local authority areas would have a higher level of success, and this is part of the time scale that spreads backwards, if you like, from January when the code number is required, to December when the Revenue have to calculate it, to way back in the previous year to the time when they are finding out who is where, because with one's residence there is a tendency nowadays to regard the postal address as the only thing that matters. I notice, for example, my own driving licence - and maybe yours too - does not give counties any longer. It gives some hieroglyphics; it gives postal codes. Now it may be that it is possible to link postal codes in with local authorities; I do not know.

Q: One of the views expressed in any scheme if it were to be adopted two or three years' hence, one of the ideas canvassed to us is that it would be perfectly practical to treat the present postal code rather as enumeration of districts in census are treated, and thus code them up.

-A: It is just that we would not want the problem to be overlooked because

it does so easily involve the intervention of the employer. One's postal address is very often quite different from one's local authority address. Funnily enough, I was talking to a colleague only this morning who is actually running our payroll section. He lives in a town in the vicinity of Hemel Hempstead where half the village is in Hemel Hempstead and the other half in Berkhamstead, and the Inland Revenue's parish book really does not help in this marginal area, and could involve an employer intervention.

The second point I wanted to raise which I have not mentioned up to now is what could be described as the audit trail because it does seem to me more than likely that somebody would want to link the money received by the local authority with the amount deducted by the employer. It may be that the Inland Revenue are going to administer the scheme perfectly adequately on the basis of samples, and that can achieve quite accurate results, given the right assumptions. It may be thought that Parliament will seek to follow this up in slightly greater detail and that could move the employer nearer towards the system of regularly totting up the LIT appropriate to each of the 520 first and second tier authorities, and that would be a major task.

Q: There are several features on that, are there not, that we should have to be careful about. One would have to be careful about how many taxing authorities there were. You were saying that if you used the sampling method here it would have to follow that it would have to be properly conceived. Do you have any particular points in mind in that regard?

-A: No, I was merely saying we are not against the sampling routine principle.

-A: Not merely are we not against it, but the cost of employers breaking up their payrolls between local authority areas would be enormous.

-A: You would then need 520 memories in your machinery.

Q: One of the things that might make local income tax a little more bearable

to employers would be if one could find some way of lightening the present burden on them from the present PAYE system. Are there any sort of suggestions or any thoughts that you have had about the way in which the present PAYE system could be made more tolerable to employers?

-A: My immediate reaction is probably that there are adequate channels at the moment between employers and the Inland Revenue to think these out as and when they occur, and do something at the time. I think on the whole we have a very equitable, fair, sensitive income tax system, a PAYE system on the whole which goes down reasonably well, and I think where there are rough edges frequently they are negotiated out of difficulty by an approach to one's own inspector of taxes. I would say on the whole there is not a large area where there could be a saving of work by the employer without disregarding the long tradition of fairness and accuracy and sensitivity that is built into the tax system at the moment.

-A: I think that is true on the mechanics but it is on the query side that the real problems occur.

Q: Supposing, for example, some way could be found of reducing drastically the number of changes in coding in the year that presumably would be a very considerable help.

-A: It would be a help, yes.

-A: Unfortunately, you see, the individual gets married, or has a child, or takes out a mortgage and so on; you are dealing with people, you see, not just employers. But it comes back on the employer.

Q: It would depend, I suppose, on reviewing the number of present forms of deduction and seeing if it could be done more economically.

-A: Indeed, the big thing and the thing we put to the Tax Credit Committee, and we felt very strongly at that time, was that a golden opportunity was being missed of doing away with this regressive tax which is called insurance and is not. That is the major step. If

one could do away with this, quite apart from the saving there would be in the public service, that would make an enormous difference because in addition to calculating PAYE now every employer has to calculate the employee's wages-related contribution. We have already got one local income tax, you know, we have already got two taxes in that.

-A: We have not looked at the possibility of combining LIT with NIT.

-A: We wrote three papers altogether to the Select Committee on the Tax Credits because it seemed to us to be quite incomprehensible when you are looking at what of itself was basically an extremely good idea not to seize the opportunity of really simplifying the system.

-A: With the Tax Credit system it did envisage the possibility that given some form of deduction of tax at the source on mortgage interest to get relief there and then you could abolish a large number of the personal allowances and therefore take a chance perhaps and get rid of the lot of them and have a flat 30 per cent deduction of tax from all wages.

-A: Yes, that was in the happy days of 30 per cent.

-A: That was the sort of system and, for example, that disposes of the problems under the "lump", which is causing a lot of administrative work for many people now.

-A: But if you did away with the, as I say, so-called national insurance as far as the employee was concerned and had a straight payroll tax on employers - after all the employer pays it at the end of the day; the employee regards himself as taking home cash - the difference between that and the original figure of gross pay in the employer's books is not a matter of great significance to the employee at all. How much simpler to do away with the thing altogether, adjust your tax system or tax credit, and then have a straight payroll tax, a percentage of payroll, so all it is is you add up your total payroll and then take a percentage of it, but of course it would involve a great deal of unemployment in the Newcastle upon Tyne area.

Q: Could I take you back not to the thought of getting rid of the present national insurance contribution but to not so long ago when it was essentially a fixed amount and then it changed to the earnings-related contribution. Did that cause you to buy a new computer?

-A: It was additional payroll work. It was a substantial increase. Coming back to our steps, effectively what it used to be for each employee you had—and in those happy far off days they were not adjusted every few months to take account of inflation; there it was, it was the same week in, week out, year in, year out—the man over 18, the boy, the woman over 18, the girl, and the woman on the special thing because her husband was paying contributions, five rates, and there they were, they went on, week in, week out. Then suddenly you got a new set of tables to work out graduated contributions, which was an enormous extra burden in terms of adding up working operations, and indeed if you have the time to refer to this paper we put in to the Select Committee on Tax Credits we did describe that as one of the stages we had gone through in the last twenty years, from a payroll, gross pay, employers' contribution, PAYE, net pay, employee's contribution, PAYE, net pay, employer's contribution. That is all there was unless you had a superannuation scheme or whatever which in those days also was fairly rare, but payroll, employee's graduated contribution, and that of itself it is apparent straightway will increase the work load.

Q: Is that of the order of magnitude of the problem that would be involved in introducing an LIT scheme of the type we have outlined to you?

-A: I should say it would be very similar. In fact it would not be quite as bad as that, given that inasmuch as the employee's gross pay remains unchanged—so you had the person who was on a fixed rate—all right, except when the level of deductions changed it was the same week in, week out, month in, month out. The chap who was on fluctuating rates causes the problem. In

PAYE you have to check the figure every week, every month, because even the chap who is on a fixed rate his earnings are up 5p, down 5p, so it is probably much the same.

Q: Could I generalise the point I put to you a moment or two ago. I do see quite well you have your contacts with the Revenue from time to time about these things. Can I put it this way: if the Government were in fact applying their mind seriously to the introduction of a local income tax, obviously you would want them to look very closely at the impact on the employer on his payroll, and indeed I think you would expect us if we were to say anything about this to draw attention to this. The other side of that is that if they should in their wisdom decide that, notwithstanding all the difficulties, a local income tax was something they rather wanted to go along with.

-A: Perhaps part of the social contract.

Q: Yes, indeed. One need not perhaps speculate about the precise motives. If they were so minded, would it not be from your point of view highly desirable that they should look at the same time at all the other things that are required of employers in relation to their payrolls?

-A: I was really saying that taking the existing PAYE scheme broadly as it is, its rough edges have been smoothed down very considerably, and any steps that the Revenue can take to lighten the work load on the employer they do take. For example, they allow employers to print their own forms where it is to the advantage of the employer, and they do agree shortcuts where the answer is again compatible with the legal requirements.

-A: The Revenue both at the local inspector of taxes and the national level at Somerset House I think by and large are the most human government department of all to deal with contrary to popular belief.

-A: And one of the most businesslike too; it is interesting.

Q: Could we go to paragraph 12 of your paper, and looking at the 10 steps post-LIT, as opposed to the six steps in paragraph 8, pre-LIT, given the assumption that they are required, can we just get a feel for the extra burden which steps 4, 8 and 10 actually do imply? Is it three-tenths of the effort? I suppose the answer is no. So can we get some feel of these three steps in a manually operated payroll.

-*A:* I would have said that the things that take the time are the turning up. I suppose you could do it by sitting the individual down and using a stopwatch. Effectively you have got to select the different tables, that is the first thing, and in point of fact employers bill their payrolls usually for their convenience and not for the convenience of the tax system. In other words, all the employees in this department, or this shop, or this branch, will be on one rather than the way - which you might say - of grouping them into local authority areas so as to stick with the same tables. You have got to select the tables first and then pick up another one after. You have then got to check on that and find a number. You have then got to take that number and write it down there. You have then got to do an addition. The resulting number you have got you have then got to do a deduction from the one that you have already done in the first one, which was an addition.

-*A:* First of all you have got your taxable pay. You have already got that for both taxes. You have got to take your tables, you have got to say what is the total taxable pay to date for that code, so you have to find the individual on code 52 is so much and you have to write it down. You have then got to deduct that from the gross pay to date to arrive at the taxable pay to date, which you have to do for PAYE. You have got to do that operation all over again so there is a straight doubling of that operation. You have then got to look up your next table and say what is the total tax to date. You have got to write that down. You have then got to take away from that the tax that was

paid up to the last pay day to arrive at the tax due this week. Now those are probably the major parts of it, and I would have said that to say that the increase of 10 as to 6 is an increase of 66½ per cent, that might well be a fair estimate but it might be more than that. It is very difficult to tell. It depends on the way you are doing it. This is the actual, sheer, physical job; I do it for mine.

-*A:* Could I make one other point associated with that. I cannot just put my hand on where I got the idea, but there is a feeling that the LIT might be non-cumulative.

Q: You mean from us?

-*A:* Well, that is what I am not sure, whether it came from my conversation, but we would certainly prefer cumulative. It may make no difference at all but we would want to line it up with the present tax procedure.

-*A:* In point of fact the Tax Credit Green Paper claimed that that was non-cumulative but by definition it has to be cumulative, and no amount of use of words and twisted logic will make it anything else but cumulative.

-*A:* I am sorry, this was just an aside, in case.

Q: I do not think we were contemplating on the sort of lines that we are examining at the moment that it would be non-cumulative.

-*A:* The people who are the worst affected are the people who do their payroll on the keyboard machines, equipment, because I would hazard a guess that I should be most surprised if every one of those was not put into a position where they would have to buy new equipment, new machinery, because of the extra registers required. The cost of a keyboard machine does not go up in arithmetical progression, it is geometric progression, and I should be most surprised to find anybody with a keyboard machine which has spare capacity, which means the whole machine - it is not like a computer.

Q: Probably they have just all bought

new machines for the earnings-related insurance.

-A: They have got a problem there. Do not forget we had the earnings-related graduated contributions; that is not a major problem for them.

Q: I am probably ignorant, but what are these keyboard machines?

-A: Basically it is a series of adding machines with a typewriter built into them. It is a series of adding machines and adding machine registers operated by a keyboard, and you have got to have a register for each calculation.

Q: For each step?

Q: If you add a step you cannot add a register?

-A: It is not like a computer, some of the more modern computers, where you can add capacity by adding on a larger store or something.

-A: Is there not a limit to the number of registers?

-A: It depends.

Q: Is it mechanical or electronic?

-A: Mechanical. It is the step before you go on to computers, and I would have said that there is a minority of employers in this country in numerical terms employing computers but a lot do their payroll on mechanical. I have no idea what the statistics are. But it is possible if you got in touch with National or Burroughs, the two main suppliers, they might give you an indication of the number of their customers who use keyboard machines for wages. They are the two main manufacturers in this country - both, alas, American!

-A: If I can mention another area where occasionally little details keep coming up, the Inland Revenue introduced an alphabetical suffix to code numbers to enable budget changes to be reflected much faster. They chose letters, and the consequence of that was that people with computerised payrolls were not able to control the way the Revenue data was fed into their machines. The normal practice is to add everything up. It may sound silly to

add up, for example, all the code numbers of a few thousand employees but it is one way of ensuring that you have got the right total, and we could not add up letters. So it meant that there was not the right sort of control over the HLT that one would have liked.

Q: Are not employers' associations consulted before that sort of change is made?

-A: Evidently not on that one, no. Usually one is. It may be that it did not occur to the Revenue, although there are links with their computer people. If the same thing happened with local authority income tax, say, or LIT, again it is an area where extra work would be put on employers because of peculiarly irrelevant detail. I mention this as one of the sort of strange things that catches you unaware at the time.

Q: There would have to be close consultation over a long period about the total relevance of the scheme if the Government were to avoid these things.

-A: One other thing is I would have thought there was some danger that sooner or later - danger in one sense and hope in another sense - the Government will have to go back to reduced rates of tax. It simplified the administration of PAYE enormously to have this one flat rate of income tax, full stop, but now you have got the extra 5½ per cent and the basic rate has gone up to 35, so that you have a marginal rate, the moment you step over the threshold you are in 40½ per cent, and if we add a local income tax on top you are getting then to what is a very, very heavy burden of tax on an individual who just steps for the first time into the tax scale. I would have thought that the sheer weight of this, and we quote here the example of the man who is on £40 a week, whose effective deductions have been 11.7 per cent, and he regards that as his rate of tax. He gets an increase and finds it is not his rate of tax. His rate of tax on the difference is 40 per cent. If they had still got reduced rates the problems of introducing a local income tax would be infinitely greater

than they would be now. How do you deal with reduced rates for local income tax? It complicates the thing enormously it seems. Under the reduced rates you used to have not merely weekly free pay tables but weekly tax tables. The tax tables that you see now, you have weekly or monthly free pay tables, but just one cumulative tax on taxable pay tables. When you have got reduced rates, you have to have as we used to have weekly and monthly tax tables as well as weekly and monthly free pay tables. So this is another factor which if the Government should wish to go back to that would make it more difficult for them with local income tax I think, unless you are going to accept that you would reduce the effect of the grading. I am all against doing this because it is more work.

Q: Can I raise one last question with you which is perhaps of some interest. There are a number of European countries who have three taxes operating in this general field, national income tax, local income tax, and VAT, with all its difficulties. There does not, as far as we can judge, appear to be any very great problem there about operating it. What are the main reasons why it seems to work tolerably there but presents major problems here?

-A: A very much lower level of overall taxation is almost certainly the answer plus to some extent slightly less sensitivity in the tax system itself.

Q: The actual level of tax – and I am talking about it from the employers – is the question of acceptability, of age and so on, but in terms of the problems for employers, I can see your point that it is less sensitive.

-A: I think many of these in any case have been built up side by side over a period of years. I am being a bit broad here perhaps; probably they have been ironed out as they have gone along.

-A: It would be nice to know how they work.

Q: I wondered if you had any views about it.

-A: We cannot have views without knowledge. We could no doubt have made enquiries.

-A: To give a parallel instance, it was said if continents can work VAT why cannot you British work VAT. The answer simply was that in the past the continental countries had their sales taxes at retail level on actual turnover. France was a bit slow in introducing them but they had a history of sales taxes. The UK did not. It had the wholesale tax, the purchase tax. Therefore we had a much greater stumbling block in achieving VAT, and I think that this is probably what lies behind the acceptance of state and local taxes. One certainly hears complaints coming from New York – New York is a bit in the news at the moment – about the weight of local taxes in New York for some time, long before the threat of bankruptcy appeared. I do not think it goes without saying that because foreign countries have their local taxes that they are wholly accepted.

Q: Could I just take up what you are saying about the shift from sales tax compared with purchase tax. I am not saying it is not important, but does that need more than a very careful transition and that you must not move too suddenly from one to the other?

-A: The continental countries certainly achieved it over a transitional period of perhaps fifty years, but the right sort of preparation ought to produce the right answer. I must confess that if we can introduce VAT and have the bulk of it working in a couple of years, the country broadly ought to be able to cope with other possible changes.

Q: Provided there is preparation for the change?

-A: Going back to your foreign parallel I have a feeling that no country in Europe has a PAYE system as sophisticated as ours. I have a feeling that many of them may adopt, for example, the American type of situation where you have a percentage deduction without the sophistication built into the PAYE system, with the result at the end of the

year in probably the majority of cases that combined with the deduction means the Revenue do not have to worry any more. In America they have the principle of self-assessment, so that the individual then unless and until the Revenue find him out has his basic deductions, he assesses himself, pays over the balance and hopes the Internal Revenue do not come along this year, so to speak. I imagine that something of that nature is probably used in continental countries. As far as I am aware, I think we have a peculiarly sophisticated system based on a combination of PAYE and deduction of tax at source from other types of income, which makes the parallel perhaps not quite a fair one.

-A: The thing of course is that with the lower rates of tax, people are more acceptable to broad brush treatment. The rather higher rates in this country require greater precision, and that is now endemic to the British character.

Q: Well, we shall read the paper with care. However, if there is anything we do not understand perhaps we may ask you when we have had an opportunity of looking at it. May I say even from a first glance what a very useful document it appears to be to us. We are very grateful to you for giving so much trouble and attention to it. It is useful,

you will appreciate, particularly from our point of view, to try and get a clear idea of what you are likely to concentrate on in any aspect of particular features for the future. So I think it is a very helpful document of its kind and we are very glad to have it.

-A: I think our approach to LIT has a certain element of the camel's back about it. There is so much happening to the employer at the moment. Were we starting in a less complicated world, one's views could well be rather different.

Q: I do not think any of us would fail to sympathise with that particular feeling, but apart from if we have any queries about the paper, if on reflection you have any further points that you think you would like to make to us, provided they reach us fairly soon we would certainly give them most careful attention and we would appreciate anything you could add.

-A: Thank you very much, we may well have.

Q: We have our eye on the calendar a bit at the moment. May I conclude by thanking you very much for giving us your time. We have enjoyed listening to you and talking to you very much indeed.

Oral Evidence by the Confederation of British Industry—14 November 1975

LOCAL INCOME TAX— POSSIBLE BURDEN ON EMPLOYERS

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ORAL EVIDENCE — CONFEDERATION OF BRITISH INDUSTRY

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Q: First of all, may I welcome you and your colleagues here. Thank you for finding the time to come and see us again. Can I first of all just set the scene as far as we are concerned, and what we are immediately interested in today. You will remember that in March this year you were kind enough to come and talk to us about your thoughts about the subject of this particular Committee's concern, and we had a session together then and during that we canvassed a number of points, including the possibility of a local income tax. It was I am sure, as the session showed, evident to you then as it was to us that one of the matters with which the Government and Parliament will naturally be concerned, bearing in mind the background that led to our establishment, was what were the pros and cons of a local income tax and what were its advantages and disadvantages compared with other forms of possible local and central taxation which might fund local authorities. At that meeting, you promised to let us have a further note which you sent to us in May of this year and in which you dealt with a number of matters of direct concern to your Confederation. In working our way through these problems, it seemed to us that we had not had from you as much as perhaps it might be useful for us to have concern-

ing further indications about what Mr McIntosh called — in his letter to Mr Stevens dated 11th November this year — the direct practical problems that some form of LIT might raise with employers. Can I add to that what I think is apparent from the correspondence, that our principal concern today about those direct practical problems has a negative and positive aspect. We have taken into account in our deliberations all the points you have made to us earlier about the effect of local income tax on wage negotiations and a host of other points which you either mentioned at the meeting in March or included in your comment in May, and we understand what is said about that. But, as I say, going through it we were not at all clear that we had learnt enough from you for our understanding of these problems. On the positive side, the area that worries us most, and on which we particularly want your aid, is not for the very big employers — we understand the problems but they are perhaps rather easier to assess — but principally for medium and small employers. For example, particularly those without access to computers and with no large, skilled technical staff to assist them on the taxation side. So it is those problems on which we are particularly anxious to have your aid, especially if you can take further the observations

that Mr Crowe made to us in the paper he gave us and the information he passed to us about the likely staffing problems that members may encounter.

So what we are primarily concerned with are these direct practical effects upon employers, bearing in mind that we have heard and I hope fully understood what you said about the wider connotations which are of course serious and important and to which we shall have to give a good deal of attention.

Now I do not know whether you would like to start off, but that is the field and I hope I have indicated it sufficiently clearly to indicate what our primary concern is today.

-A: First of all, thank you for giving us the further opportunity of coming to you and thank you for putting the problem again to us. We have met as a working party of CBI on this again and with this particular point of view in mind, and this time we enlarged our working party to involve the middle or small firms because we wanted to make certain we felt certain we knew their problems. We went into this I think in very much greater depth probably than we did before, but the end result is that we are really horrified, if I may put it bluntly, at the thought of a local income tax, of the effect it could have on industry and commerce, and particularly the small trader. I think you yourself said, Sir, that the larger firm, with its computers and so on, could probably cope with this problem, but it is going to have, we think, a tremendous effect - adverse - on all firms and particularly so to the small firm.

Now the administration, the staffing, of it; I think you touched on that. Our researches have confirmed this for the small firm: for example, you take the grocer on the corner of the street who has already got to deal with goodness knows how many things, VAT and everything else, who has this put on to him, it could well be the last straw. The thought that we have considered is what is all this going to achieve, if a local income tax comes into being, and we are not quite sure what you may have

in mind at the end of the day, but as we understand it it is a personal income tax, and you are going to divide the financial position or the support to the local authorities into two. You are going to say for the services rendered to the community there are going to be two things, there is going to be industry and commerce which would continue to have a rating system, and the personal income tax, and we assume, rightly or wrongly, that you may well have in mind that if a local income tax came into being it would be administered by the Inland Revenue and that the local authority would say "We anticipate our expenditure next year is £X million; we can see we are getting £X million from industry and commerce, therefore we want £X million from personal income tax" and an assessment is made. Now the employers have got to gear themselves to put a return in to the Inland Revenue, or they are going to have a demand sent from the Inland Revenue to say Mr So-and-so has 5 per cent or 5p or whatever it is on his tax deducted for the local income tax.

A local authority have a staff to deal with rates. We cannot see that they are going to save any staff if there is still the other side, the industry/commerce, so therefore there is no saving for local authorities there. Industry have got to put themselves ready to deal with this further administrative burden, perhaps not very much of a burden, we are prepared to concede, in the larger firm but quite a burden on the smaller firm. But the Inland Revenue have got to deal with it anyway and the thought of setting the procedure up to begin with is horrifying, because at the moment the Inland Revenue have no reason to know and they have no idea where people live, are they in XYZ district. . . .

Q: I wonder if I can interrupt you. I appreciate what you say and these are very serious considerations. You have in the main mentioned them to us before and we fully understand that it is a very serious and important matter. We have heard from the Inland Revenue about their problems, and I think we appre-

ciate those. Our difficulty is not to understand the generalities - these have been borne in on us by now you may take it from everybody. Whatever is done, there are going to be massive complaints and real complaints, and we do not wish in any way to suggest that they are not very important. Our problem is to get some real measure of them, because in the end the Secretary of State, quite apart from us, has got to say "I am going to get a lot of complaints and a lot of difficulties about costs and burdens of any system; what I want to do is to get some measure of it when I look at it initially". That in turn is our problem, when we come to look at the actual burden on the small and medium sized industries in particular. Of course we shall not ignore the burden on the large industries but as you rightly say it is at the smaller level where the worry is. Our problem is to get some understanding of what sort of staff, what sort of time, what sort of additional anxieties and worries in addition to what they have to do anyway. If you can help us with some of the measure, so that we can understand exactly how big it is, what the time scale involved would be, what the staff requirement would be, in orders of magnitude, that is I think our real concern. Please do not think we have forgotten the other things.

-A: Our difficulty is that we do not know what you think. If you could say to us "If we did this or recommended this . . ." then we could say to you we could cost it, but at the moment we do not know what may be in your mind. It is very difficult to say, is it going to be done by the Inland Revenue or is it going to be done by local authorities, are they going to have the right to put a direct local income tax on people. If we could know a little bit more - and we have got a host of questions we would like to ask you - but at the moment I feel my colleagues feel that we are a little bit in the air as to know exactly what might be proposed. If you tell us a proposal, we will tell you what we think it will cost.

Q: I think it is quite inconceivable that a Committee sitting for 18 months, dealing with a proposition that has been around for eighty years . . .

-A: Queen Anne.

Q: No, not Queen Anne, no, but certainly eighty years, since the 1890s at any rate, could possibly devise a total scheme. Moreover of course, as your colleagues would be the first to realise, there are other considerations, even if we made a recommendation and the Government were to accept it. The question of what the various departments were going to do, what industry and local authorities wanted by way of the shape of the scheme would lead to a fairly formidable set of consultations before the thing which could fairly be called a scheme had been achieved. But I think you have already been given an indication by Mr McIntosh of the general nature of what we have looked at as an approach, because anything further would have no reality in the long run because it could get affected by a lot of pressures probably put on the Government when it was designing a scheme properly so called. But I think so far as the general matters are concerned, I think we have already indicated the sort of stalking-horses we have in mind, and we now want to get the shape of the idea, and to try to measure the general impact. We do not think it would be possible to do more than that general assessment at this time. I think whatever our views were the Government would no doubt want to explore it very carefully with the bodies such as yours and others, but I hope in terms of the general points we have given you as much indication as we can about that. I would have hoped that would enable us to have a bracket; of course it would vary a lot about the centre, if you put a lower figure and a higher figure as a general indication. It would help us to get some idea of how you think the thing is capable of being assessed.

-A: If I could just add a bit to that. As you know, I wrote a paper earlier this year and I have talked to various

people about the sort of figures that I came up with there, and I see no reason to depart from them. There is a lot of guesswork in this but I hope it is reasonably intelligent guesswork. I think the difficulty of the small business is that you cannot really measure this in financial terms. In the large business you can say "Well, this is going to need an extra one, two or three staff", or whatever it may be "and this will cost so much". If you take the man running his own business with five to 10 employees, the odds are that he does all these Government impositions himself. If he is a builder or decorator, or something of that kind, or a shopkeeper, he will do the PAYE, the VAT, and the LIT if it comes about. He will not recruit anyone, quite obviously, for this additional job. What he is doing is diverting his attention and his time from what he regards as his business - his proper business - to these other things. I do not have a large contact myself with small businesses except as a private individual but certainly amongst our members at the smaller end - not as small as perhaps half a dozen employees but at the smaller end - there is a very strong feeling that they are spending all their time working for the Government, as they put it, and doing things that they do not think they ought to be doing. I think it is terribly difficult to say that is going to mean extra numbers of staff or what the cost will be. There is undoubtedly a cost to the individual because he is devoting his time and energies to things that he does not regard as his main activity, that is, what he gets a living from. But one can only, I believe, in giving overall figures, cost that man's time like you cost everybody else's time. If he is working out PAYE he is not doing something else which would be for the benefit of his business and there is a financial cost somewhere but it does not show up necessarily as extra people.

Q: It is foregone, so to speak.

A: That is right, and I think that is the great difficulty. There are a large number of small businesses in this area,

and as my colleague has said, having just digested VAT the thought of having a go at something else is not one which is very attractive.

A: May I just add to that? I imagine that being the new boy here it must be because I run what must be one of the smallest businesses in the City. When you are running a tiny operation - we have in London in fact only four people; I operate by having a business of four people here and I have four people in various centres throughout Europe but each of these is self-contained and operates individually - the cost to me personally in terms of lost time which I would be able to charge clients, who incidentally are mainly foreign clients who would be producing hard currency, through doing, if you like, Government work, VAT, PAYE and all this, is running at the moment at practically £2,000 a year. Now if I were to take on LIT in addition I would not have to take on any more staff. It would probably still cost me £2,000; it might cost me £2,100 or £2,500 I do not know, but a little bit more than £2,000. But the fact of the matter is that whereas at the moment I am working perhaps 12 to 14 hours a day I may later on be working 13 to 15 hours a day. Now that is not the kind of thing which can be quantified, but nevertheless the loss to me personally in terms of wear and tear, the loss in terms of the staff in the office who have to follow behind me at whatever rate I choose to drive them at, the loss in terms of taxable income to me, and to them, and even to the other operations that I run in Europe, these are the kind of things that are not accurately quantifiable, but believe you me if you are running a small business where you are very, very near the line the whole time it can mean quite a lot. I suspect there will be a lot of people in our position. We do not run what you might call an unintelligent business. Everybody in my outfit is either a graduate or a lawyer or a Chartered Accountant - someone of that ilk - and we are perfectly able to handle these things. They give us no particular intellectual problem, but nevertheless

while we are doing things like LIT, PAYE, and all the rest, we are not doing the things that we are in business to do.

Q: Can I summarise it in this way: you are saying at any rate as far as your own personal understanding of such a system would go, it may not involve any further staff, but the marginal increase is a very significant one and the margin is already under pressure. Is that a fair summary?

A: Every time we get nearer a margin, things become that bit tighter; we think that bit less of the UK; we think that people in Continental countries are doing that bit better, which of course they clearly are, than we are here, and it drives us a little bit further away from the spirit of the UK, and this is happening repeatedly. We incidentally are advisers to quite a number of firms of all sizes, small, medium, large, and I think what I am saying for my own concern in London is reflected absolutely accurately in the minds of any company that we advise.

A: I am also a newcomer to this Committee. I am in fact part of an organisation which has many, many, many small traders, in fact predominantly grocers' shops, and approximately 4,000 of them at that, and these are really small businessmen, often employing one or two people, and sometimes just themselves and their wives. I think I would agree entirely with those who express the view that there is not a great deal of extra work involved probably in an LIT. One assumes it would have to be pretty simple and I would imagine that is the way anybody would think at the present time. One would assume it is a system added on to the present Inland Revenue system. What would concern a small businessman is I think above all else his present attitude that he is being loaded almost every month with some new government legislation which he is required to carry out. Over the last two years I have noted down a few of the problems which we have had to try and advise and help the small businessman on. Right bang slap at the top of the

list must be VAT which indirectly has a major bearing on this whole subject because this has had an enormous effect on the small businessman. We happen to believe that having got involved in VAT it is an absolute nonsense of a system to operate because it is terribly expensive and clearly has cost the small businessman quite a bit of money, let us say half a person a week perhaps, over the course of a year. Now he has had VAT to deal with. Over the last two years because of the counter-inflation legislation he has had to do a lot of work for the Price Commission. Never mind what his size, he has been involved with the Price Commission, in one way or another. He is involved there more recently with price surveys which he has got to bear in mind rather carefully. Even now the Government is talking about a new scheme on controlling certain prices to 5 per cent and cross-subsidisation, things which only frighten the small businessman. He is involved with a number of statutory returns which come in quite regularly and are also quite frightening, even though the design of them has improved somewhat. He has to fill in these returns. He cannot send them to somebody else to do; he has to do them all himself. Recently we have had the Equal Pay Act which is now causing concern and new wage rates. There is government legislation pending on pensions. Many small businessmen do not have pension schemes. They are going to get involved in that quite soon. They are intimidated by the wealth of legislation. However you set up a new scheme, you are going to have to provide them with some written explanation, and the present tendency is to toss it aside. Somebody has to try and train them. In my own organisation we try to train them. All the trade associations try to help but the training takes a lot of time and costs a great deal of money. They are frightened by more and more paperwork coming to them, although eventually they usually understand it.

I find in practice they do not understand a lot of the recent legislation and are now getting to the stage where they

do not wish to understand it. They are getting pretty violent about the whole thing. You have seen the small business associations rising. Their complaints are pretty well justified if you are sitting where they are sitting. Their job in life is to try and run a small business and try to make a profit in so doing. Very commonly at the present time they face the ire of the public because inflation means that prices are going up in the shops and the first person that meets the complaints is usually the shopkeeper. Now if we have a local income tax they are going to face more fire, and the fire is going to be from employees because one of the greatest fears one has about this sort of thing is that the total deductions from an employee's salary are going to be more in the end; the net take-home pay is going to go down. When I was first involved in this subject, which was in fact only this week, my initial biggest fear was the enormous disincentive to an employee even though in total he might not be paying more if one combines the local rating system and local income tax. The tendency is to fire at the person who is paying you or is knocking off tax off your salary. Now the small businessman is shot at from all directions and he is going to be shot at a little bit more by his employees, and I think that, plus the wealth of legislation, is what worries. You cannot quantify the extra cost of administering this kind of system. I think that would represent the views of many small businesses.

-A: We have gone into this looking not only at the point you put to us but at the difficulties if it came in, and we could spend a long time telling you the practical difficulties. I mean, a man who has got a mortgage, he gets his interest allowed, and therefore it brings down his taxable income. We could go on a long time telling you the practical difficulties apart from the administrative costs.

Q: I do not see why the mortgage point should in any way complicate the system. It would have to be taken into account in the tables and deductions. . . .

-A: The man who has got his own house, he owns it. A man who is buying it with interest on a mortgage, his taxable income is going to be reduced because the mortgage interest is allowed. Therefore, if he is charged 5 per cent on his taxable income for a local income tax, compared with the man next door, identical house, who does not have a mortgage, with deductible interest, 5 per cent on his taxable income is going to be that much more.

Q: That happens now.

-A: By the present rating system both pay the same.

Q: That may be an incidence on individuals, but why should that be a burden on employers?

-A: Because the employee in this house pays more income tax and therefore it is the employee who is going to say to his employer "I want more money".

Q: He has that now.

-A: This is something else, it is another one.

Q: Does that not apply to two neighbours who are employed by the same firm now?

-A: They both get the same income.

Q: If Mr A has deductions to be made, whether due to mortgages or not, which move the allowances which he is entitled to claim up or down as compared with the man next door who has a different set of deductions, the amount of money they will have to pay at any given rate of tax on the net income would be different.

-A: Yes, that is right.

Q: What I am seeking is why the introduction of a local income tax should in any way alter that situation qua the employer.

-A: They are both paying the same amount to local services and suddenly employee A has to pay more than employee B, and I think this would have a trade union effect.

Q: That is why a large number of members of the public argue for LIT. I quite see that we have not seen any solution, and I do not think, if I may say so, you have put any before us to deal with the present argument about local expenditure which does not have masses of pros and cons. We all accept that. What is the most difficult aspect of our task is to distinguish between things which are a feature of one scheme and another, and in today's session we are concerned to identify if we can either any that we may overlook in terms of the impact on the employer - I take your point about the employer getting the brunt about what he pays or does not pay the employee - and secondly as well as identifying them if there is any way in which we can get their scale and their sense that would be helpful to us. Now as to the wider aspects of what the public think of LIT that is a much more difficult problem, I accept that, and is fraught with all sorts of problems. But what I am most anxious to have today and I think my colleagues are is anything that you can give us on either the scale or the feel, the sense of what is the impact of this on an employer doing his job, as you rightly say, with all sorts of statutory hazards already.

A: Do I understand that the LIT - I think this must be correct - will be based on the same sort of income as the national income tax?

Q: Broadly that is right.

A: If the two are going to part company, then employers are going to be left quite clearly with a considerably higher expense than if they were the same. On the other hand, if we have the national income tax and the local income tax based on the same figure, are we going to make the same sort of adjustments - without particularising - in arriving at the LIT as we have at the moment for the national income tax? We mentioned, for example, the question of mortgages.

Q: I think we have already fully answered these points to you in our

letter dated 6th November. Perhaps I could just ...

-A: If I could just interrupt at that point, one which is not in and which I was going to lead you to just in a moment is the question of what happens if there are deductions given in arriving at the national income tax which you would not wish to give in arriving at a local income tax? I am thinking, for example, of what happens if you have a man with foreign income.

Q: Have you seen the letter of 6th November?

-A: Yes.

Q: Could we all follow it together because I am anxious not to take up time on things on which we have already expressed a view, and what we want is your reactions. It is the letter of 6th November in which Mr McIntosh is anxious to put the general points which we are discussing. "Thus" it says in the last paragraph "a LIT might operate on the same rules and conventions which apply in the national tax system for taxing personal incomes; such a LIT would apply therefore to investment income, Schedule D, as well as the PAYE scheme. The LIT might operate alongside/together with the national system for assessment and collection; with variable local rates of tax set by reference to an individual's place of residence, determined annually in advance of the tax year. The employer's normal role would be to deduct at the appropriate local rate of tax (which could be part of the relevant code number) in addition to the national rate and make over the total tax collected to the Inland Revenue." Now as I was saying earlier there cannot at this stage be any set scheme - it is just not a feasible possibility - but the letter indicates at least one major way in which it might be done and very largely - I have to be very careful as there are certain exceptions to it - that is assimilating it, if that scheme is followed, in almost every particular except two, into the national scheme. One is that the local rate which would be varied at the deter-

mination of the local authority as rates are now, would affect the code, and secondly it would depend to an important though not exclusive degree on the place of residence which the present system does not. I am not saying there are not minor variations but those are really the only two major variants on the sort of view canvassed there. Does that deal with the point you are raising?

-A: No, it does not.

Q: Well, let us start again.

-A: We are assuming I think implicitly, and Mr McIntosh I think must be assuming – obviously in the short letter he must be taking the broad approach to the thing – that we have a tax base, we have a total income which consists of all the Schedule E, all the Schedule D, everything else under the sun all grouped together into one single . . .

Q: When you say total income you mean an individual's total income?

-A: Yes, an individual's total income. All this is aggregated and just as that aggregate would at the moment be subject to PAYE it will now be subject to PAYE plus a local income tax surcharge. In the straightforward case, no problem whatsoever. However, one can envisage one or two problems which would arise. What, for example, are we going to do in the situation where we have a taxpayer whose income is not at the moment expressed in aggregate terms or taxed in aggregate terms? The sort of thing I have in mind here, for example, is that somebody has a main source of income which is a Schedule E source of income, subject to PAYE, and a number of adjustments are made in the coding to code out other income.

Q: But this is not an employer's problem. It may affect your coding; it may mean that the code is altered more frequently than otherwise would be the case.

-A: And this of course will affect the employer because the more frequently the code number changes, which will happen the more frequently the quantum of any source of income built into

that code number is changed, the higher will be the cost to the employer.

Q: Very well, I accept that. It will change from time to time depending on how frequently . . .

Q: But it will not change any more frequently than it does now.

-A: I think it must do.

Q: What brings about a deduction is a common factor in a local income tax and a national income tax. This is why I went back to this part because it assumes assimilation. It does not assume – Mr McIntosh will tell me if he thinks I am wrong – that you take one deduction for one part of the income tax and one for another. If I am going to get a bigger mortgage, if I am going to have investment income, if I am going to have anything else that leads to a deduction under the present PAYE system, and you are keeping my records as an employee, you will get more or less frequent coding depending on how often my deductions are required to be altered, but whether I am paying LIT or not will not alter either the nature of the deduction or the frequency with which the coding occurs.

-A: That will apply even to the situation where a code number is such that, for example, in the case of a person with nothing but foreign income, where the code number gives effectively a nil tax deduction, there will be nil local income tax payable either?

Q: Well, it will not be payable through the employer. If the chap is in the PAYE system, it will affect the employer. There will of course be quite a number who are not affected by the PAYE system, and then it will be identified in that system. But that is another problem.

-A: Yes, I understand. In the case of a person who is within the PAYE system, but whose income is totally coded out, because it is all foreign income, for example, so that he will pay no national income tax, he pays no local income tax either.

Q: That is common to both systems.

-A: So he is totally exempt from all contribution to local services in those circumstances?

Q: I go back to my assimilation. I think I am right in saying the two systems, with the two exceptions I have mentioned, would be common to both, so the technical impact of whether I paid or whether I did not, whether I was liable to have my code number changed or not, would be a difficulty of the system but it would be a common difficulty. Now there are difficulties outside the PAYE system but they are a non-employer problem.

Q: The model I have put down here I repeat is nothing more than a talking point. It specifically assumes that whatever incomes are assessable for national income tax will be assessable for the local income tax, and if it so happens, in our wisdom, the country has chosen not to tax people for income tax purposes on foreign income then the same assumption goes over to the local income tax. As to whether that is fair or not is another issue.

-A: I see, he would be exempt.

Q: I hesitate to say "exempt" because it depends on the state of the legislation from year to year, but if he came into the tax system for one purpose he would come into it for the other. The two would run *pari passu*, with the two exceptions I have mentioned, so that whether you are in or whether you are out may be a complex question and if the last five years are any indication will change frequently, but it will be common. If you have to put in a new deduction at the Inland Revenue end, you will still have to put it in whether there is an LIT or not, and *vice versa*.

-A: If this happened it would mean that from time to time as with PAYE at the moment you would get under payments and over payments. How would that affect the LIT, because the under payment is a specifically national income tax underpayment?

Q: Qua the employer's end, which is what we are looking at, that will not affect him in any way different from the way in which it affects him now because as the cumulative system works it would pick up deductions at the rate at which they catch them up.

-A: May I come in here. We do not know how many rates there are in mind for the local income tax. You might say you want no more than five or 10 rates, or surcharge tables if you like. Now let us assume there is an under payment situation as arises on PAYE, one of the common methods is to allow for the under payment in the following year's coding, and there are I believe about 300 code numbers which indicate the rates of allowances. Now then, supposing we have an individual with a substantial LIT under payment, the three, four, five, ten rates, would not be able to deal with that situation. Have you thought about this point?

-A: I think they both go together do they not? You code in the national income tax payment and you recover that and you therefore recover a higher amount of national income as well. The only time you get a problem is if the national income tax rate is different for the two years.

-A: The two are certainly going to part company.

Q: If there is an under or over payment it is likely on this sort of scheme that one would not be able to identify it as national or local; it would simply be this chap had not paid enough. We have in mind the same process as now used to code in or out in subsequent years could be done with a reasonable number of steps, just like the problem arises at the moment.

-A: Are you thinking of an aggregate rate therefore, that the deductions should be one lump sum, because this would make it very simple but the employee would not then be able to identify the local and the national income tax?

Q: The two are not incompatible, are they? It depends on how you present

them. As far as the employer is concerned, it is important that he should identify the aggregate sum he has got to deduct. From the employee's end, it is important that he should understand how that sum is made up between local and national. It would mean the presentation and form was different.

-A: You lose accountability then.

Q: Yes, unless it is presented clearly.

-A: But even so, I think an employee looks at his take-home pay, when he gets his wage packet, but when he gets a rate demand he says, "This is too much, I'll go and see my local councillor, and I'll create what I can."

Q: We are moving off on to whether the scheme is a good scheme or a bad scheme. I accept that there are all sorts of things of this kind. What we are really wanting your aid with is the way in which the rub at the employers' end is going to make life more difficult for the employer, expose him to more criticism, or any of the other things that would be difficult or non-productive.

-A: Yes, I appreciate that, but we cannot in our line divorce the end of the day cost to industry, and we do feel very strongly that with a local income tax there could be a shortfall of the local authorities because of wrong assessments and that sort of thing, and where are they going to get their money from? They are going to get it from the commercial and industrial properties by putting the rates up, we think.

Q: You made the drawbacks about a local income tax when you first saw us, you made them when you came to see us in March, you made them in your letter in May. Please accept from me that we have read them and we follow them. A lot of other people have made them too, and they will have to be weighed. But as I say what is most helpful—and what you have said is most useful—is to try and get a clear sense in our minds as to exactly how big or how small would be the work burden, or the diminution of the productivity, and skill and enthusiasm, and any other

drawbacks that a scheme along these general lines, following these general set of principles, would have for employers. Now we accept—let me make it absolutely clear—that there are a lot of other drawbacks, and you cannot just take the cost without other things as well. We can only look at one thing at a time otherwise we would be apt to lose sight of what it is that we at any rate are seeking. Now are there any other difficulties that you have been able to identify which would be likely to be a burden or drawback or a handicap of any kind on employers that has not been mentioned? This is what we are after.

-A: Can I give you a totally unquantifiable one, which I am sure everybody must already have harangued you about. If you have got an employee and you are paying him well and his income is so large that he is already paying tax at the top rate, 83 per cent, and he has got some investment income and perhaps he is paying tax therefore at 98 per cent, and we stick on a local income tax of the kind of figures we are talking about, 5, 10, 15 per cent, whatever it is, we are going to take him right over 100 per cent. Now one cannot quantify the disincentive effect of that, but I know the effect it would have on my people. As I say, I am sure other people must have mentioned this.

-A: May I mention two practical points which I think come back again if one is considering a local income tax. I am not clear in my mind as to how many rates of local income tax a single employer would have to apply, but one of my colleagues mentioned when we were talking about this yesterday that it is quite common for an employer to have employees who live in twenty rating authority areas. Now there would not be twenty rates of local income tax—well, there could be of course since each rating authority would have a different requirement. But I assume that one is thinking of bringing the number of possible rates down to a manageable proportion. One would therefore I assume have a surcharge tax table for the local income tax rates and one perhaps would

get back to the days where—and I remember this with the PAYE system—one had a great number of tables to flick through to find out different rates. For each employee therefore I would assume you would have to find and flick through the relevant table. Is that correct?

Q: We outlined two possibilities in my earlier letter. One is much as you say; there could be a separate table for each allowable rate of local income tax. And we had in mind that one could devise a scheme that was not a surcharge table but was in fact a composite national versus local table, to avoid adding up, and in fact we have seen schemes of that nature in other countries. That is one possibility. The other possibility is that there could be a surcharge percentage applied to local authorities, a surcharge on the national income tax, which would in fact require either a computation or a percentage addition to the national income tax by means of a single entry in a ready reckoner. Those are the two simplest schemes we can think of which will allow for variable additions to be made, a set of surcharge tables or composite tables, or a single entry in a ready reckoner, according to the percentage applicable to that man.

A: The point I am making about that is that the lesser number of rates clearly the better. The second point is I am assuming that you would want to credit, as it were, each individual with the amount of local income tax paid on his behalf, rather like the graduated pension scheme whereby each employee in the country was supposed to get a little slip every now and then saying how much has gone in on his behalf. Now is that in your mind at the moment?

Q: I am glad you said "from time to time". We have tried to make the scheme simple. We have in mind it might be possible to allow a total deduction to be made weekly or monthly with an indication given from time to time—it may be perhaps we could do it monthly to enhance accountability or it

could be by means of a more general statement at various times during the year, particularly at the end of the year of what you have paid, or particularly at the beginning of the year of what you are going to pay. But we have in mind a scheme should be devised which avoids every week and every month the employer having to do a precise breakdown of the amount of tax. That was the point I was coming to. He would want to pay over, if he has this sort of thing, one lump sum, in the way that he already pays over PAYE and NHI sums, so an LIT sum.

We do recognise though, as you pointed out, a scheme which did only take a total deduction which the employee did not recognise as being broken down into parts could have problems of accountability.

-A: Going on from there, how frequently do you see the employer having to identify the particular authority for whom he has collected local income tax?

Q: I think this is answered in the letter. Clearly the frequency of dates on which you have got an assessment, whether on the basis that my colleague is posing now or whether in terms of identifying his residence and therefore the authority to whom to pay, must be kept to a minimum, from both people's ends, both from your end and from the Inland Revenue end. I think the simplest way of doing that is once a year. That does not necessarily make up the point that my colleague is taking, but it might well do.

-A: Certainly that is the way we would like to see it develop.

Q: One of the things we have been kicking around is the employer would not have any responsibility for identifying the place of residence. It would be the Inland Revenue or someone else. That is the kind of stalking-horse we have been trying out. Then you pick it up from the form you get from the Inland Revenue about the chap and that leads you on to the appropriate table or ready reckoner.

-A: Can I mention also that I think it does to a certain degree come back on the employer, a sort of chicken and egg situation as I see it, in terms of this; the code number I think is normally issued round about November/December in the tax year. The rating precept at the moment I think is usually determined round about February. So one immediately has a sort of out of step timing position.

-A: This is an initial problem.

-A: I see it as an annual problem. I think I see it as a continuous problem. You are therefore going to call upon local authorities to determine their precept three or four months earlier when, particularly in these inflationary days, they will have far less idea as to what they are going to call for by way of local income tax. Or are they going to wait as of now and produce the answer later and cause a change in the coding, a change in the administration problems there? Another point as I see it is if you are going to tie this to a national income tax system, then surely the local authority will wish to know what is in the Chancellor's mind which of course it cannot know when it asks for its rate per pound.

Q: There are two different types of problem here, and two different contexts. First of all, can I leave the transition side because that is a unique feature of change, and you have a special transition. Secondly, I think it is certainly quite clear, if administrative flexibility and financial responsibility is to be effected, the more closely the programmes can be co-ordinated the better. But I do not think we could take LIT with all its complications separate from other matters such as grant and public expenditure survey and other matters, so that there would clearly have to be a major look at the timetable of everything that goes into local income tax, grants and national income tax, to ensure that so far as possible they are brought into some sort of harmony. This is one of the main reasons why I was saying a little earlier that you cannot look at local income tax only in the local

government framework. It would have to be looked at by the Government rather more widely. What you can be sure about is that it would certainly be our aim if we were recommending it - or even if we were not - making it clear that these various programmes need to be co-ordinated in such a way that the demands on each part, you, the Revenue, and each individual local authority, bear some close relationship so that you do not get them out of phase. I think we would feel that some of the problems that are about at the moment are due to lack of co-ordination. So we have that point very much in mind, and insofar as it is a matter of impact on the employer, we certainly recognise that not only the simpler but the less repetitive the events are in sequel to him clearly the better.

-A: May I ask, as a matter of interest, what you had in mind for the two homes situation?

Q: This is a very difficult one I think. I do not know that at the moment we have any final feel about that so far as we are concerned. It presents a great many problems. There are quite a lot of those problems on the fringe. But I should just go back to the point you made earlier. If you thought we necessarily accepted that view it might colour this. You were talking about payments for services rendered. It does not necessarily follow when you look at a local tax in that sense; it might, or it might not. You should not assume that we are necessarily looking at it in that framework.

-A: What happens when an individual changes his residence at some time during the year?

Q: Well, I think the simplest thing is to make it an annual event, one annual date at which it was taken, because obviously if you depart from that you get immense additional complexities of the numerate kind. The actual operation does not change but the frequency with which it has to be done becomes very complicated.

-A: I wonder how far it really is possible to keep records of addresses up to

date. Everyone who is moving to a lower tax area will be very keen to notify the tax office so that it is effective from the next 6 April or whenever it may be, but someone who is moving into a higher tax area is not going to take any action at all. I do not know whether you would have in mind with any scheme of this kind that the Inland Revenue should seek information each year about changes of address. In no time at all one would find that everybody was living in one county which happened to have a particularly low tax rate with accommodation addresses and all that sort of thing, and some areas would have no residents at all. There would be plenty of people there but they were all registered somewhere else.

Q: That clearly is a very important point. There are a number of ways in which you might persuade people to keep their residence up to date.

-A: What would happen if you had a district or area, entirely agricultural, where the majority of the residents are under the taxable income? This could happen. I can think of a district council where their tax I am sure is entirely agricultural.

Q: This begs two questions. First of all, at what level you would raise the tax.

-A: I was assuming that the tax would be on the taxable income.

Q: I was meaning the local authority level.

-A: Oh, I was thinking district council.

Q: You are making that assumption. It does not necessarily follow. The answer is obvious; if you happen to have a low tax yield you will not get much tax. As at present, there would have to be other elements in the system to take account of that.

-A: At the moment, every resident pays rates, finances the local authority.

Q: Every resident does not pay rates. Every householder pays rates. That is one of the great complaints.

-A: I beg your pardon, every householder pays rates.

Q: That is not true.

-A: Well, I know. You are making life difficult! In theory every house has a rate on it and rates are paid. Now if all the householders were under the taxable income, there would be no income.

Q: I do not think that is at all likely but it does not matter how you postulate it, on any tax if the thing which triggers the tax off is not there you do not get the tax.

-A: I can think of a district in Cornwall where there is industry, yes, but I reckon that most of it is rural, where probably there is a very low income.

Q: At the moment in a lot of rural districts you have exceedingly low rateable values. In that respect both of them present problems.

-A: This is where CBI are worried because you could have very little local income tax coming in and the rates for local authorities would have to go on industry.

Q: Well, we are moving away from the point in issue. But let me just answer that. Clearly, if there were a system adopted in which there were a local income tax and rates, and a method of ensuring that the two were not allowed to fluctuate unreasonably in relation to one another, it would clearly have to be part of the system. But could we go back to the employers?

-A: At the end of the day the employer wants to make money.

Q: I do not want to leave the topic until I am sure we have learnt everything helpful we can. So far as the LIT component in that structure is concerned, should there be one, along the general philosophic lines as set out in Mr McIntosh's letter, are there features and problems created by that tax as such - direct practical problems - that we have not yet appreciated?

-A: The points made by my colleagues

really highlighted that. I cannot think of anything.

-A: I must confess I am still rather worried about the adjustments, whether they are Schedule D or Schedule E adjustments, things like retrospective adjustments for benefits in kind, and that sort of thing, which can only be ascertained after the end of the tax year.

Q: That is right, but that is an Inland Revenue problem, not an employer's problem, for the very good reason that if the general thesis which Mr McIntosh has adopted is to be followed, all that you have to ask yourself is whether those events would create a different situation either in amount or frequency from that which the national system adopts. It may have other criticisms elsewhere, but qua the work burden and the problems put on the employer I am not persuaded myself at the moment that it necessarily indicates anything materially different, indeed different at all, because the events will not change; the things that cause a deduction to be made by the Inland Revenue tax office now perhaps by the PAYE code will change but they will not change because it is an LIT system; they will change because government or his circumstances change the thing that causes the deduction. It is not a feature of a local income tax, not on the basis that is here suggested.

-A: We can see considerable problems for the Inland Revenue which we are only touching on, but we could go into greater detail. However, I am sure they have presented their own case. But what does concern us, I would add, is this, that if the number of people involved in the Inland Revenue increases substantially, we feel that in the end we are both going to bear the cost and find a lower standard of attention to PAYE matters perhaps, which is in any case not particularly good at the present time. There is a vast amount of work which is not dealt with quickly and this also affects the employee. For example, there is the whole question of refunds and dealing with assessments. It is well known that the Revenue in many areas

are way behind with this work and this means that an employee does not get a refund or perhaps does not pay the additional amount that he should do, but either way it takes a while to deal with, and very often the employee will complain to his employer, when there is a delay in a code change. I must admit that the whole area of the problems encountered by the Revenue in retrospective adjustments is one of great concern and would affect us in the end: the whole timing question, where assessments already take two or three years to conclude and then the additional LIT assessment would take up even more time.

Q: Could I ask a question not so much about LIT but about the present burden of the PAYE system. How important a complicating factor, how difficult does it make the system, that the code changes during the currency of the year? Is this a thing that adds substantially to the employer's problem?

-A: You cannot say substantially but if you take an individual employee - and let us assume that the employer has not got any machinery and he does it himself - I would say if the employee's code number changes in the week normally speaking there is not a great deal of extra work. (Mind you, a code change also affects people on mechanised systems and computer systems. You have got to tell the computer or tell the mechanised system.) There is not a vast amount of work, except where you get situations of people having a total change, the circumstance where they are married, where you have to link the old records and open up new records and deal with them as a new employee. There is a fair amount of complication there, but to be fair it is not a vast amount of work.

-A: On the other hand you may just be saying that is for one. If everybody changes because of the system it is a different question.

-A: Certainly where we have a situation where the tax rates change in the Budget and there is quite a lot of recoding to do that does get complicated and is

time consuming and very annoying.

-A: And certainly if you do not get your timing coinciding; if you have a twofold change which causes double the work.

-A: And now presumably if we have an LIT a change of address is a further thing which has at least to be recorded. It is the recording of these things which tends to take the time rather than the application of tables.

Q: Hopefully, the change of residence will only be picked up at the annual coding. That was the idea. The idea was to insulate the system from changes in addresses during the course of a tax year. They cannot be entirely insulated whatever system you have obviously. There will be occasions when there is a dispute about the address and so on, but it should be possible to reduce that to quite small proportions.

-A: Yes, I can understand that, but I do have a nasty feeling that a system can start off as a simple model and in 10 years' time it is quite unrecognisable. The income tax started off as a very simple thing. With VAT we have got extra rates. I think all we have said about this does assume a simple model, and if it became more sophisticated then even for the large employer it would make a significant difference to the burden. If, for example, local authorities said eventually "We would like to charge X per cent on the first slice of taxable income and Y per cent on the balance" or something like that, we are getting into a completely different ball park. A change of residence during the year is relatively minor, although that would be unwelcome, but one could soon envisage all sorts of situations which would be most unwelcome to employers.

Q: I entirely appreciate your point about things that start simple and tend to become complex, and clearly that would be something that would need to be watched. But I think I would say three things about it, all of which must necessarily be assessments and nothing more. First of all, there are signs that

this is being appreciated to a degree that has not been true for the last twenty years, partly because of the pressure on administrative margins, and now there is an incentive in a way to try and improve it because we are getting to stages where it is recognised that it is counter-productive. Secondly, there are systems of LIT in operation in various parts of the world and I think it is doubtful from that experience whether it seems necessarily to follow that a local income tax does proliferate the technical details which some taxes seem to get into. In particular, I would have thought there are no signs that it is going to have enormous complexities at varying levels. It certainly is not inevitable that that is going to be so, and some of them have subsisted for long enough to see that if they were going to get vast proliferation it would have occurred in all the systems by now.

Q: There is one particular point I would like to raise in responding to an earlier remark. I said there were perhaps two possibilities for making the actual deductions, given a local authority reference or code number. One was to appeal to a particular set of composite tables, and the other was to make the national tax deduction as now and then make a percentage addition based on the appropriate percentage for that local authority. Is there anything in either of these that makes one sound much worse or much better than the other? I appreciate it follows a highly detailed question. Is there anything obvious which says that one is preferable to the other?

-A: I would be much happier to look at that rather carefully since I do not competently follow all the details. It is when you sit down and look at some of these things carefully that one can comment. I would rather not in this situation make a snap judgement.

Q: We would be very grateful if you could look at it.

-A: I would appreciate it, if we are to look at it, if you could set out what you mean, almost as examples without

any commitment whatsoever, and then one could give an opinion.

Q: Yes, certainly, very helpful.

-A: There is one point I do not think Mr McIntosh's letter covers. You talk about the tax base being precisely the same, i.e. earned and unearned income and so on. But as to investment income for national purposes a lot of it is taxed at source. Did you have a view as to whether local income tax should be deducted at source or not?

Q: There were several variants on this but I do not think we have any concluded view. We would be interested to hear whether you think it has any impact on your end.

-A: Well, we have got a view on this. I think that generally speaking my colleagues will reinforce what I am saying that we would be pretty much against a local income tax being deducted at source.

-A: But in so doing you would therefore need lots of additional assessments by the Inland Revenue which of course is very much their problem.

Q: Could I just ask, is this view based on the administrative complications or on some more general feeling about it? I can see you might regard it as inconvenient to have to deduct at different rates according to place of residence. Is that the bother or is it a bother in a general way?

-A: I think it is probably the different rates one. This one came out quite strongly at our meeting yesterday.

-A: It would be impossible to deduct at various rates. Very often you would not know who the beneficial owner of the interest was anyway. So it would have to be a guessed rate, an average rate, anyway, and there would presumably have to be an adjustment afterwards.

Q: I was just wanting to know whether this was where the area of bother was.

-A: I think that is only part of it. The point is that so much of this income

would go to exempt bodies, institutions, companies, charities, and all that sort of thing. Now it would be very unwelcome to see this cash taken out of the system in this way. If you take interest on Loan Stocks, well over half the income goes to institutional investors who presumably will not be liable to local income tax.

Q: They would be able to claim it back.

-A: They would be able to claim it back, yes - presumably arrangements would be made for that - but that is not a complete answer to the question, if I may say so. I think people do not want to have to get the tax back. Certainly if they happen to be non-resident individuals or corporations or something like that, they do not want to get mixed up in any of this.

-A: Apart from that, of course, their net cash receipt is going to be that much lower until they get their repayment which nowadays is even more important because by the time they get the cash it is worth less.

-A: But if on the other hand it is paid gross then you have the complication of having to make an assessment at the end of the year. This of course is a Revenue problem again.

-A: There is one point that has not been touched on. With businesses having to operate schemes such as VAT, National Insurance, etc, if we get one more thing like LIT put on to it, this strengthens industry's view that there should be some form of reimbursement for the extra expense involved.

Q: That is a wide issue of principle.

-A: Yes, I agree.

-A: Of course I would make the plea from the other end entirely on this thing, that, yes, in an emergency we get paid something for doing this, but the more you could take away the better, and that is a very serious suggestion. Does one ever stop to think even of the present PAYE system and how much reduction there could be in the work load? I suppose for the time being we cannot give up VAT because of the

Common Market requirements, but can one consider what could be done to reduce the work load? Nothing ever seems to happen in that area.

Q: Your experience obviously is wide outside this country. There are a number of European countries where both the LIT and VAT operate. Does it present the same burdens as it does here?

-A: Both local income tax and VAT? This is an enormous question and it is one that I find extremely difficult to answer. The whole balance of taxation in this country is right out of line with just about everywhere else in the Common Market. We are not in this country in aggregate over-taxed, despite what the popular myth says to the contrary, but we have a uniquely destructive system in the United Kingdom, that it has certain areas where certain people are stricken greatly whereas in others larger numbers of people tend to get away with things relatively lightly. I would have thought that if we are going to consider VAT there would be a massive amount of scope for raising the rate from 8 per cent to whatever is necessary to produce the kind of yield which a local income tax would produce. Despite what my colleague says, it is probably not any more difficult, and marginally easier possibly, to have a 10 per cent rate than an 8 per cent rate. At least the worst fraction you have then got to deal with is one-eleventh instead of two twenty-sevenths.

-A: I do not disagree in any way!

-A: So if we are trying to marry together somehow a local income tax and a VAT or even consider the situation where we have them both together . . .

Q: I am sorry, perhaps I put my question wrongly or carelessly. We have been talking about the difficulties, the burdens, lack of incentives, brought about in the employer's hands by having to deal with a number of taxes, VAT currently at four different rates, and all these kind of things, with the question in mind, will it be significantly altered by the addition of a local

income tax, along the broad path that Mr McIntosh indicates. It inevitably causes one to ask at some point this is done elsewhere in countries not so wildly dissimilar from us where both a local income tax operates and VAT operates. What I was seeking your aid with, since you obviously have knowledge of the field, is whether in those countries where you do have all three taxes, that is to say, a national income tax, a local income tax and VAT, is it so organised in a way that does not present the same administrative frictional problems?

-A: Yes, I think so. The problems that we have in the UK particularly with direct taxation are really twofold; first of all, the national characteristic of complicating even the simplest problem which you do not get to such an extent abroad, as we have here. We start off, as my colleague says, with a simple system and before we know where we are goodness knows what happens to it. This is something which is almost peculiar to the UK.

Q: In search of fairness.

-A: In search of fairness, yes, I think that is perfectly right; also I think very often in terms of short term political advantage. I mean, you can bring in a huge betterment levy which you could easily have done and produced the yield to the same effect if you had simply had a higher rate of capital gains tax or a slightly different definition of what would be taxable income. This is the kind of thing which we tend to adopt in the UK which is something which is almost peculiar to this country. The second difference I think between the UK and other countries is the very high marginal rates of tax. You have other countries where people pay as high taxes in aggregate as in the UK but different people pay them. In the result, there is a tremendous incentive in the UK and a tremendous commercial advantage to avoid tax by the time you get to a certain level of income. Now this tax avoidance is going to be all the more profitable the higher is the rate of tax. If you add local income tax

to national income tax there is going to be that greater element of avoidance and so forth than one gets at the present moment. So I think that to try and compare the system in the aggregate with what we have here in comparison with those of other countries one has to take into account the characteristics and the way that the systems have developed. I would think that we are really asking for trouble in this country if we try and superimpose a local income tax on the kind of marginal rates that we have got here. This is by far the most important comparison that one can make with any other European country without exception.

Q: Can I take that one stage further. Apart from the rates of tax which are a very special and difficult problem, comparing us with European countries where there is both a LIT and VAT, are there in your judgment changes that could be made in the way the national system of income tax is arranged here which would give houseroom to the additional administrative burden of local income tax?

-A: Yes, I think so. You merely have to look at our income tax statute to see the length of it in comparison with the length of the taxing statute of any other European country, once again without exception. Our statute is absolutely littered with largely irrelevancies which produce no revenue at all but which either sounded good politically when they were introduced and have therefore been left because nobody has had the feeling to change them, or else full of the kind of thing you have been talking about, the equity argument. The two are essentially inconsistent. You can have a short statute which has a greater degree of unfairness than we would be prepared to tolerate or else you can have a super refined statute which is so complex that the thing becomes unworkable. We have the latter.

Q: Could I come back from that noble level of generality to something practical. What actual things do you see being done in the administrative

field affecting employers which would help to provide an easement on the employer?

-A: The first thing one would do is have a look at what happens in, say, Holland or in Germany or in France, where they accept that the Pay As You Earn deduction system is crude. It never produces the right result, but there is a final reckoning at the end of the year between the Inland Revenue and the taxpayer. The Inland Revenue assess the taxpayer on under deductions, over deductions, and cash changes hands. We do not do this in the UK. We try and have the deduction absolutely and utterly spot on, and we succeed to the extent that only 10 per cent of Pay As You Earn cases ever have to be the subject of an assessment. So what we are saying in the UK is that although the cost to the Revenue of the Pay As You Earn system is extremely low all that has happened in effect is that the burden has been placed on the employer.

Q: Does it follow from what you are saying—it may not follow, I just want to know—that overall costs of a non-cumulative scheme can be shown to be cheaper over all than a cumulative scheme?

-A: No, I do not think so. It just depends—it is this question of equity again—how near the mark you want to get and who is going to make the adjustment to get the thing spot on.

Q: There are two ways of looking at this, one which is at least marginally beyond this Committee, namely, looking at the philosophy of national taxation—and thank God it is. Alternatively, one can say really that is much too vast a topic and in any case even if one wrote a thesis on it it is not likely to get anywhere unless one can identify areas where specific things can be done. So if I may leave that aside, without in any way being unsympathetic to it, to stay well within the framework of the administration, if you are going to make a change, can you use that change, very much as you were

suggesting, at the same time to make other administrative changes of an identifiable character which at least will hold the promise of more economic administration and produce a less fraught situation altogether.

-A: Could I be a little bit particular here and say that the great weakness of PAYE in this country is when an individual moves from one employer to another, the so-called movements procedure which you get inside the Revenue. This is where the thing begins to creak a little, and it begins to creak the more that people move jobs. As over the last twenty-five years or so people have tended to move more frequently, this particular creak in the PAYE mechanism has become the greater. The Revenue made a bold attempt at getting round this problem by trying to put the whole thing on to computers and it did not work too well. As I understand it, they have now dropped it. In honesty, I do not think it is fair to expect the Revenue to attempt any further changes of this kind in the meantime. So the biggest creak, if you like, is in movements.

Q: What do we do about it?

-A: You want to get a system man in - not me! I do not know how it can be done. It is an absolute menace as far as employers are concerned, and as far as the Revenue is concerned.

Q: I do not think you need to persuade us about that. I think we would entirely agree about that. It is much more difficult.

-A: I think what we have to look at in order to try and simplify PAYE is to say that through the PAYE mechanism we accept that instead of being correct in 90 per cent of cases we are going to be correct in 40 per cent or 50 per cent, a considerably lesser figure.

Q: Correct in what sense?

-A: Correct in the sense that there will be no assessment necessary on the individual employee at the end of the year. The target could be reduced a bit so that it is maybe a little bit more con-

sistent with available Revenue staff, both numerically and qualitatively as well.

Q: Would that help you materially as to movements?

-A: No, it would not help in movements, but it would help in the number of adjustments that the Revenue has to make in PAYE coding, and therefore it would release staff to be able to make the kind of adjustments which we might have to build in if we have an LIT. I think I am right in saying - my colleagues here will correct me if I am wrong - that we have something like 35,000 people involved in PAYE at the moment, in the Inland Revenue, and of those 35,000 I would say at a guess - and I am wide open to correction - that perhaps 4,000 or 5,000 are involved in movements and the rest very largely on coding work, or something of that order I am talking about. So if we could reduce the number of coding adjustments that have to be made we are talking about releasing possibly even 10,000 or even 15,000 - I am thinking of a figure out of thin air - perhaps in order to make whatever adjustments would have to be made for the LIT.

Q: I am getting a little confused here. I do not think those of us who have heard the Inland Revenue problems will doubt your proposition about the problem of movements. If I follow you, you are saying you have no solution as far as you are aware for dealing with that central dominating topic.

-A: I have no suggestions to make as far as movements are concerned but I have as far as simplification is concerned.

Q: Separately from that comes the question can you reduce the rate of deductions independent of movements. Well, I quite see what you say about the level of perfection, but what in practice does one do about the frequency of deductions?

-A: It is the frequency of changing of code numbers which is the nuisance both to the Revenue and I think to a

much lesser extent to the employer. So anything which can be done to cut this down would be helpful and that would release more staff, as I say, to take on LIT work.

-A: I think one of the things one has to beware of in looking at a thing like local income tax, any tax system, or any system is that perhaps 95 per cent of it will work reasonably well, but the cost comes in with the problems and the queries. This happens throughout business. Most things work smoothly and are quite cost efficient, to use modern jargon, but it is the queries, for example, the code changes, the under and over assessments which cost a lot. I am pretty sure that within the Inland Revenue a great proportion of the PAYE system works quite smoothly and it is just a very routine and very boring task for a lot of Civil Servants working in the Inland Revenue. The problem comes and the time is devoted to these individual assessments. Now if you have got a local income tax one of the least things one has got to learn from the national system is something which my colleague was touching upon. If you are going for exactitude, you have had it, because the cost will be enormous, and after all whenever you look at a tax system you have got to consider the costs of collection. I think in discussing this amongst ourselves one of our fears has been that the costs of collection would be greater than the present costs of collection in the rating system. I believe that this would be the case. If you are going for a very precise system you have got a problem. On the other hand, you have got to set against this equity and the taxpayers' concern that the amount they are contributing will go to the right place. Overall a system can seem to be simple if you look at it in general, but when you start getting into details, particularly in this country, you have problems. When the VAT system was introduced, the Government said it was the simplest in Europe. It was not the simplest in Europe. It was a long way from the simplest in Europe, because they said it was a single rate and it was not a

single rate. It was in fact three rates right from the beginning. I do not believe from dealing with Government Departments that at that time they really understood and even now fully understand the problems it does cause for business. Yet they were led to believe at the beginning and they believed themselves that it was a simple system, but it is not. It was not and it is not now. In fact, it is getting worse.

-A: I am not too sure that employees generally would be happy with no change during the year. I think the tendency would be to get for themselves, whichever way round it was, a better code; they have had more children, they have taken on a mortgage and this sort of thing, and therefore they do not want to wait to the end of the tax year, although it may be nice to have it in a lump sum. I think they like to see it move. This is just a practical point of view so far as the employee is concerned.

-A: It is of course impossible under the present system for a code number to go adversely during the year.

Q: Well, thank you very much indeed. It has been very interesting and helpful. We will set out, if we may, the points that Mr McIntosh raised with some framework, and anything you can give us to help us to measure the general nature of it, in quantitative or sense terms, I think we would find very helpful. I think the problem of the congestion of the tax system, frequency of deductions and other matters of this kind are ones which we feel very sympathetic to, so if you have any further points on that which are within our reasonable framework and do not appear too long after this event, we would certainly be very grateful to have them. On reflection I do not think there is anything that needs to be said in that direction, remembering that though obviously we need to look at some distance outside the strict field of local finances, if we are talking about any form of taxation other than rating there is obviously a limit as to how far we can go without taking things so far

out of context that what we have to say would be of very little value. But subject to those limitations, if there is any other way in which you can help us on both the quantitative elements, even if it is only in orders of magnitude, of the impact on employers, and in anything that gives a sense of, as you were rightly saying, the detraction that it makes from other tasks and things of that kind, to give a feel for the nature of the problem, I think we would be very grateful. We will bear carefully in mind what you have said on this point as indeed we will bear in mind

what you have told us on other points.

Please do not think—If I may just end on this note—that in concentrating on this particular area this afternoon that in any way means that we have forgotten that it is necessary to balance these considerations along with a lot of others, including what benefits may or may not come from changing the tax system one way or the other. But there are of course a very large number of drawbacks to one person which turn out to be an advantage to others. But we shall certainly keep in mind all that you have told us.

Local Personal Income Tax Systems in Sweden, the United States and Canada

REPORT BY COOPERS & LYBRAND
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INTRODUCTION

1. We were commissioned by the Committee of Inquiry into Local Government Finance to carry out a brief study of the local personal income tax ("LIT") systems operated in Sweden, the United States of America and Canada, with the aim of assisting the Committee in assessing the relevance of the experience of those countries to the possible introduction of LIT in the United Kingdom. We were asked to identify the essential features of the LIT systems operated in the three countries, with particular reference to the administrative implications for individual taxpayers, for employers, who might be expected to take a part in the collection of LIT, and for the taxation authorities.
2. In carrying out this study, we visited Stockholm, New York, New Jersey and Toronto in May 1975 and discussed the various aspects of LIT with tax officials, national and local government officers and tax partners and staff of Coopers & Lybrand offices in those countries. We also met a large employer in Stockholm and another in New York for the particular purpose of ascertaining the procedures for, and burdens of, dealing with LIT in relation to salaries and wages. We are most grateful to all those whom we saw for their assistance in providing us with information. A list of the people principally involved is attached at Appendix D.
3. Although local taxation is charged on the income and profits of corporations in each of the three countries we visited, we were instructed to confine our enquiries to the application of local taxation to individuals.
4. In this report we first outline, in paragraphs 5 to 13, the main features of LIT systems operated in Sweden, the United States of America and Canada, more detailed descriptions of these systems being set out in Appendices A, B and C respectively. We then set out, in paragraphs 14 to 19, a summary of our findings on the main features of the systems in the three countries which should be taken into account in assessing the feasibility of introducing an LIT system in the United Kingdom. Paragraphs 20 to 21 set out our conclusions.

SWEDEN

5. The main points of the LIT system in Sweden may be summarised as follows. The system is described in more detail in Appendix A.
 - (a) There are approximately 2,900 different local authorities, operating at three different levels, which levy tax on personal incomes. As a result, each individual is subject to three local income taxes in addition to the national income tax.

(b) Incomes are assessed to LIT in the same amounts as for national income tax purposes. Deductions, allowances and reliefs are the same as for national income tax purposes. There is, however, a difference between national income tax and LIT in the calculation of the presumed income for property.

(c) Each local authority decides the rate of tax, which is charged at a flat rate on taxable income.

(d) A non-cumulative pay-as-you-go system is in operation, under which national income tax and local income taxes are combined and deducted as one amount by employers from salaries and wages by means of composite tax tables supplied by the authorities. Persons in receipt of incomes other than wages and salaries have to estimate their liabilities and make payments on account during the course of the year.

(e) Every taxpayer is required to file an annual tax return, the one return generally serving for both national and LIT purposes.

(f) Annual assessments to national and local income taxes are made upon every taxpayer.

(g) The charge to LIT is generally according to the residence of individuals but according to place of business for companies and other businesses. Individuals are required to register their residence. Their liability to LIT in any year is determined by their registered residence on 1 November in the previous year.

(h) LIT is collected by the national tax authority and distributed to the local authorities.

(i) Apart from the pay-as-you-go system referred to in (d) above, there is no system of deduction at source as operated in the United Kingdom.

6. During the course of our study we were told the following additional points:

- (a) The LIT system is generally accepted as fair by all concerned.
- (b) Most individuals appear to understand the system and to have no great difficulty in completing their tax returns. Advice is, nevertheless, available to them from tax authorities, banks and post offices.
- (c) Employers do not consider that the pay-as-you-go system imposes undue burdens upon them.
- (d) The local authorities do not consider that the adoption of the national taxation base normally involves any serious disadvantage to them. There is no demand from local authorities to operate completely independent systems of taxation. The national taxation base has, however, rarely been altered in recent years and then, if the alteration has been material, it has been accompanied by compensation payments to the local authorities from central government for any tax lost. Representatives of the county council associations did, however, remark that the tax loss payments were considered by some to be an infringement of the independence of county councils.
- (e) The national tax authority considers that the incidence of local income tax is a constraint upon the alteration or adjustment of the national taxation base because of the effect that changes could have upon local

authority revenue. The very high marginal rate of tax of 85 per cent paid by individuals with large incomes is a further constraint upon the alteration or adjustment of the national taxation base.

(f) The high level of LIT, which in 1975 has an average flat rate of 25.23 per cent, is a matter of general concern. The national income tax rates for 1975 rise from 7 per cent on the first slice of taxable income to 56 per cent on the top slice. As a result, the first slice of taxable income is taxed at an average rate of 32.23 per cent, most of which is LIT. National income tax rates are steeply progressive and the national average wage of Kr.40,000 is taxed at a marginal rate of 53.23 per cent.

THE UNITED STATES OF AMERICA

7. The 50 States and one federal district of the United States of America derive their powers to levy tax from the constitution. Each State grants taxing powers to certain city, county and other authorities within the State. In all, there are some 4,000 different authorities, most of whose tax systems include some form of a personal income tax. Strong feelings of local independence result in considerable differences in the ways in which taxable income is computed and, frequently, separate systems of collection of Federal, State and other taxes. There is probably no such thing as a typical LIT system in the United States of America and, in the limited time available, it was necessary to select two States and to examine only certain LIT systems in operation in those States. The main points that came to our attention are summarised in the following paragraphs; our findings are set out in more detail in Appendix B.

New York

8. New York is an example of an area in which an individual may be subject to three separate levels of income taxation, namely Federal, State and City income taxes. The salient features of the systems may be summarised as follows:

- (a) Each of the three taxes is totally independent of the others and separately administered.
- (b) Whilst the State and the City taxes start with the Federal base for calculating income, there are many additions, exclusions and modifications and each authority sets its own personal exemptions and rates of tax.
- (c) In addition to his Federal return, each taxpayer must file a separate return for State income tax purposes and another for City income tax purposes.
- (d) A separate self-assessment procedure operates for each of the three taxes.
- (e) Liability generally falls upon individuals resident in New York State or City. Residence is determined by an individual's domicile (the place to which he ultimately expects to return), his permanent place of abode and, in certain cases, the number of days in the tax year spent in New York. Liability also falls upon non-residents who derive earnings or other income from New York, in particular those who

commute to work in New York from a home outside the City or State.

- (f) A simple non-cumulative Pay-as-you-go system of deduction from salaries and wages is operated by employers with separate tables for Federal, State and City income tax purposes; in the case of a non-resident employee, the employer must deduct Federal income tax and the City Earnings Tax.
- (g) Apart from the Pay-as-you-go system, there is no system for deduction of tax at source as operated in the United Kingdom.
- (h) The three taxes are administratively complex, which probably means expensive, although computerisation of procedures by large employers and by the tax authorities does assist the working of the system.

9. We were told that most individual taxpayers need help in preparing their tax returns and assessing their own liabilities to taxation. Such help is obtainable through income tax agencies, accountants, lawyers, employers in some cases, and the Internal Revenue Service. The fees paid for professional assistance are allowable deductions for taxation purposes. We were also told that employers do not consider that the pay-as-you-go system imposes undue burdens upon them. The disadvantages of complexity, expense and duplication or triplication of tax administration were appreciated by the people to whom we spoke but they considered these drawbacks to be an acceptable price for local independence and there was no desire to move towards a more integrated system. An official of the New York City Income Tax Department told us that he considered it a fallacy to say that the filing of a tax return encumbers the tax procedure and he was convinced that the computerisation of the tax administration enables a multiplicity of tax returns to be dealt with both effectively and cheaply.

New Jersey

10. We also visited the State Income Tax Department in New Jersey for, although that State does not impose a general personal income tax, it levies the commuter taxes which are briefly outlined in part III of Appendix B. Commuter taxes involve a local authority unilaterally taxing income flowing across its boundary, in other words taxing income that its own residents derive from sources outside its area or taxing income derived from sources within its area by residents of another area. The New Jersey taxes cover both the earnings of people who commute to work across the State border and investment incomes flowing across the border.

CANADA

11. In Canada, only the Federal and Provincial governments have the power to raise income taxes. For some years, all the Provinces except Quebec have operated under an arrangement whereby the Federal authorities collect their Provincial income taxes, which are then calculated as a percentage of the Federal income tax liability, so as to reduce costs of collection. These Provinces have, however, more recently insisted that reliefs are granted to certain classes of taxpayer by means of adjustments, other than the percentage calculation,

when arriving at the Provincial income tax liability of those taxpayers. These adjustments are processed by the Federal authorities, which is an expensive refinement valued by the Provinces in question as it gives them additional independence from the Federal government. An outline of the system, with particular reference to the Province of Ontario, is set out in Appendix C, and the salient points of the system operated in that Province are summarised in the following paragraphs.

Ontario

12. The system operating in Ontario and, indeed, all the Canadian Provinces except Quebec, differs from the systems we examined in other countries in that the LIT levied by the Province is charged as a flat percentage rate on the Federal tax liability and not upon the income as assessed for Federal tax purposes. The main features of the system operating in Ontario are as follows:

- (a) The Province determines its own rate of tax, which is then charged as a percentage of the individual's Federal tax liability.
- (b) The Province departs, however, from the Federal base in that it has developed a system of granting the reliefs referred to in paragraph 11 above to particular classes of taxpayer.
- (c) A non-cumulative pay-as-you-go system is operated by employers using tax tables for the calculation of the tax to be deducted from salaries and wages.
- (d) The self-employed and those in receipt of investment income have to make payments on account of their liability during the course of the year on the basis of their own estimate of the tax liability.
- (e) Liability to LIT for a tax year is determined by the taxpayer's residence on 31 December in the tax year.
- (f) Each taxpayer has to file a Federal income tax return, with a separate section for information relating to his liability to Provincial income tax. He is required to show in the return his residence on 31 December of the year covered by the return. A self-assessment procedure operates for both Federal and Provincial income tax.
- (g) LIT is collected by the Federal authorities on behalf of the Province.
- (h) Apart from the pay-as-you-go system mentioned above, there is no system for deduction at source as operated in the United Kingdom.

13. During the course of our discussions, we were informed that the government of the Province of Ontario would prefer to be independent of the Federal tax base. It is, however, a condition of the agreement between the Province and the Federal government, under which the Federal authority administers the local personal income tax on behalf of the Province, that the Federal tax base should be used. The Province has, therefore, developed the system of granting reliefs for certain items to taxpayers, although we understand that this is regarded by the Federal authorities as outside the spirit of the collection agreement. The adjustments required by Ontario and other Provinces to give effect to the reliefs are now becoming so numerous that the Federal authority may soon not be able to cope with them.

SUMMARY OF MAIN FINDINGS

Collection at Source

14. LIT systems function, and apparently function smoothly, in the countries visited. While each country has a non-cumulative pay-as-you-go system for collection of tax during the year, however, none has a system as refined as the PAYE system which operates in the United Kingdom, under which the correct amount of tax is collected at source in the majority of cases.

Administration

15. It is possibly a reflection of the different attitude to local autonomy discussed in paragraph 19 below that LIT is administered in three very different ways in the three countries we visited. In Sweden it is totally integrated with the national income tax system; in New York, the City and State systems are almost completely independent of each other and, like New Jersey, of the Federal income tax system, whereas in Ontario the administration is the responsibility partly of the Province and partly of the Federal authorities.

Year-end Assessment

16. The LIT systems in the three countries we visited all depend upon year-end assessments of total income based on an income tax return which each taxpayer is obliged to file annually.

Residence of Taxpayer

17. Each system depends, to a considerable extent, upon the determination of a principal place of residence for each taxpayer: at a date prior to the commencement of the tax year in Sweden, as at the end of the tax year in Canada, but according to the actual place or places of residence during the tax year in New York. None of the officials we met considered that the determination of residence gave rise to any great problems.

Collection and Distribution of LIT

18. In Sweden and in Canada (with the exception of Quebec) LIT is collected by the national tax authority which then distributes it to the local authorities according to the actual income assessed to tax for each of those authorities. In New York and most other places in the United States of America, LIT is collected directly by the local authorities.

Local Independence

19. Although we were informed that Swedish local authorities have a long history of independence which is jealously guarded, this does not appear to have led to claims for greater freedom in determining the tax base or for local autonomy in deciding upon personal exemptions. The freedom to determine the rate of tax seemed generally to satisfy the feelings of local independence. The opposite is the case in New York and, we understand, in other areas in the United States, where the freedom to operate a completely independent taxation system is demanded and practised. The attitude of the provincial authorities in Canada probably comes somewhere between the two in that the feeling of local independence is strong and we gained the impression that, while the scope for

the Provinces to alter the incidence of taxation is limited, they would like to have greater freedom to control their own taxation systems. As noted in paragraph 13 above the Provinces do depart, to some extent, from the Federal tax base by granting various reliefs and Quebec operates its own independent local personal income tax system.

CONCLUSIONS

20. We were not commissioned to examine the administrative and technical questions and the probable costs of the introduction of an LIT system in the United Kingdom. Nevertheless, in the light of our study of the LIT systems operating in Sweden, the United States and Canada, it is our opinion that serious consideration should be given to including the following features in any LIT system that may be introduced into the United Kingdom.

- (a) The income assessed for LIT should be the same amount as is assessed for national income tax, with the same deductions, allowances and reliefs.
- (b) The administration, assessment and collection of LIT should be undertaken by the Inland Revenue.
- (c) The taxpayer should be liable to the LIT of the local authority in whose area he is resident and not the local authority in whose area the income has its source.
- (d) The taxpayer's residence on a particular day during or before the tax year should determine the local authority for whose LIT he is liable for the whole of the year of assessment.

21. The systems of LIT we examined during our study depend on all taxpayers submitting an annual return of income to the taxation authorities, although a substantial amount of the tax is collected during the year under pay-as-you-go systems. We understand, however, that in the United Kingdom the majority of taxpayers are not required to submit returns each year, so that the introduction of a system of LIT that depended on annual returns from all taxpayers would involve substantial alteration in the system for administering income tax and the resulting extra cost. On the other hand, the PAYE system operated in the United Kingdom is more refined than the Pay-as-you-go systems operated in the countries we visited and the Committee may, therefore, wish to examine further the possibility of adapting the present PAYE system to collect LIT on wages and salaries. This would leave open the question of LIT on income outside the scope of the PAYE system, for example investment income and the earnings of the self-employed, but the experience of the countries we visited suggests that such income could be the subject of payments on account during the year of assessment supported by annual returns submitted after the year-end.

LOCAL PERSONAL INCOME TAX IN SWEDEN

A BRIEF DESCRIPTION

Number of Local Authorities

1. Sweden, with a population at 31 December 1974 of 8,176,691, of which approximately 4,000,000 are taxpayers, has a two tier system of local government consisting of 23 county councils which encompass 278 primary municipalities. The municipalities are divided into some 2,600 church or parish districts for ecclesiastical purposes.

Principal Duties of Counties and Municipalities

2. The principal duties of the county councils are:

- Health and medical care
- Care of the mentally retarded
- Public dental service
- Some aspects of education.

3. The principal duties of the municipalities are:

- Basic education
- Social assistance
- Housing
- Water and sanitation
- Electricity, gas and heating plants
- Roads and streets
- Temperance administration.

Local Income Tax Rates

4. Both tiers of local government and the church or parish districts have independent taxing powers and each levies a tax at flat rates, rather than progressive rates, on taxable income. The computation of income, deductions and allowances are, on the whole, identical for both national and local taxes and no tier of local authority administration can amend this. Consequently, the terms and provisions, other than the rates of tax, are uniform throughout Sweden.

5. For 1975 the rates of tax are:

	Range	Average
County Councils	9.00-11.00%	9.12%
Municipalities	10.10-17.00%	15.23%
Parishes	Up to 3.50%	0.88%
Total	21.63-29.00%	25.23%

6. Each tier of local authority has freedom to fix its own rate. The same rates apply to individuals and corporations.

National Income Tax Rates

7. The rates of national income tax are progressive for individuals, and in 1975 range from 7 per cent on the first SKr. 15,000 of taxable income to 56 per cent on taxable income over SKr. 150,000.

8. Because of the high rate of local income tax, that tax is generally a heavier burden than the national taxation for individuals on gross income up to SKr. 75,000. Examples of tax rates and liabilities are shown in paragraph 35.

The Tax Ceiling

9. With national income tax rising to 56 per cent and local income tax at rates up to 29 per cent, added to wealth tax up to 2.5 per cent, the taxation burden upon individuals may be very high at the margin. As a result, there is a general tax ceiling for individuals so that the total of the three taxes mentioned in this paragraph is not to exceed 80 per cent of taxable income up to SKr. 200,000 plus 85 per cent of taxable income in excess of SKr. 200,000. Any reduction in taxes because of the operation of the tax ceiling is borne by the national government and not by the local authorities.

Income Assessable

10. Individuals resident in Sweden are subject to local and national income taxes on their worldwide income. Individuals not resident in Sweden are subject to taxation on income from Swedish sources only. The liabilities of individuals not resident in Sweden may be affected by the terms of double taxation agreements.

Presumed or Actual Income From Property

11. There has to be included in an individual's taxable income for the purposes of national income tax either the actual or the presumed income from real property. Generally, the presumed income basis applies to one or two family dwellings and is calculated as follows:

2% on first SKr. 200,000 of assessed value of property
4% on next SKr. 50,000 of assessed value of property
8% on next SKr. 50,000 of assessed value of property
10% on remainder.

A deduction is made from this presumed income for mortgage interest paid, and there is a base deduction of SKr. 1,000. No other deductions, for example for expenses, are permitted.

12. For local income tax purposes, the income from property is assessed at the higher of the amount included for national income tax purposes or the guaranteed amount. The guaranteed amount is 2 per cent of the assessed value and may not be reduced by interest or other deductions. This procedure guarantees to the community in which the property is situated that at least 2 per cent of the assessed value of the property will be included in the income subject to tax in that community.

Factors Governing the Rate of Local Income Tax

13. An individual is liable to local income tax in the community in which he is resident, but if property is owned or there is a business enterprise with a fixed place of business in another community or communities, income tax returns have to be made and tax paid to those communities also.

Determination of Residence for Individuals

14. Citizens are required to notify the parish authorities of such matters as births, deaths, changes of address and migration, except where, in the case of births and deaths, notification has been handled by the medical authorities. For this purpose post-free cards are available at any post office. The details are passed to the civil authorities who compile a register of the total population of each local authority as at 1 November in each year. That registration determines the county, municipality and parish to which an individual's LIT will be paid for the following tax year. For example, an individual's registered residence at 1 November 1975 will determine the local authorities to whom the LIT on his 1976 income will be paid and thus the rate at which it will be payable. A change of residence after 1 November 1975 will not affect the distribution of LIT upon 1976 income.

15. Registration on 1 November is according to main residence for those individuals who have two or more addresses. It appears that generally there is no great difficulty in determining which is an individual's main residence, although we were informed that, with LIT rates ranging from 21.63 per cent to 29 per cent, some people do try to register themselves in an area with a low rate of tax. If two parishes disagree as to where an individual has his main residence they can refer the matter to one of twenty-five 'Inspectors of the parish registration'. Municipalities can apply to the courts for a decision on the correct municipality for LIT purposes.

Administration

16. Local income tax was in operation before the national income tax and there is a comprehensive taxing act applicable to local authorities. The national income tax is built upon the local income tax basis and the National Tax Act incorporates much of the Local Income Tax by reference. In other words, the local taxing Act is the basis for the national taxing Act.

17. The administration of the taxation systems is decentralised and the Ministry of Finance has practically no day-to-day tax administration functions. The executive work of taxation administration lies with government agencies and special boards such as the National Tax Board. The National Tax Board is a supervisory authority for direct taxation in that it has the right to issue advice and instructions but not to intervene in special cases or in administrative questions concerning the assessment, collection, control or auditing of tax. It has general powers to promote a uniform application of taxation throughout the country. The administration of local and national income tax is delegated to the provinces whose boundaries generally coincide with those of the counties and these are responsible to the National Tax Board for the management of the taxation systems.

Assessment

18. The duty of computing tax liabilities and making assessments is delegated to local assessment boards, of which there are about 4,200 in Sweden. These assessment boards are made up of laymen engaged in tax reviews and assessments as a part-time occupation, with some professional assistance from full-time employees of the revenue service.

19. On the basis of assessments made by the local assessment boards, the liability for each taxpayer is calculated by the local tax office, of which there are 120 in Sweden. Those offices collect the tax and make distributions to the local authorities. The costs of those offices are borne by the State.

Pay-as-you-go

20. Sweden operates a pay-as-you-go system of preliminary taxation in that taxpayers make payments on account of their estimated tax liabilities during the course of the income year. For individuals there are two bases operating:

- (a) a withholding by employers from salaries and wages (called "A-tax");
- (b) instalments paid directly to the tax authority by individuals with significant amounts of income from sources other than salaries and wages (called "B-tax").

An individual is dealt with under the A-tax system or the B-tax system, but not under both. However, the deductions that an employer makes from earnings under the A-tax system may be increased to take account of the tax on other income (see paragraph 22 below).

Tax Tables

21. The withholding by the employer from salaries and wages is made according to tax tables supplied to him. There are separate tables according to the frequency of payment (for example weekly, fortnightly or monthly) and against the various bands of income are shown four columns of taxes to be used according to the personal circumstances of the taxpayer, for example single or married with no children. The column in the tax table to be used by the employer is shown on the preliminary tax notice. The preliminary tax notice may also contain special instructions (see paragraph 23 below).

Preliminary Tax Notices

22. Before 18 January in the income year, an employee will receive from the tax office a preliminary tax notice. This is not a demand for tax and does not specify the amounts of tax to be deducted from his emoluments. It bears a code number identifying the individual, the county, municipality and parish of residence. It shows the rates of tax for the appropriate localities and, from this, identifies the tax table applicable to that individual. The tax table identification is made by aggregating the various local income tax rates and rounding the sum up or down to the nearest whole number. For example, if the aggregate of the local income tax rates for 1975 is 26.35 per cent, then the preliminary tax notice will indicate that table 26 is to be applied. The tax tables for 1975 are numbered from 22 to 29 inclusive, which cover the range of aggregate local income tax for that year. Although the tax tables are identified from the LIT rate the amounts of tax shown in them are an aggregation of national and

local taxes so that the calculation, deduction and accounting to the tax office is made in one amount.

23. The preliminary tax notice, which must be handed over by the employee to his employer, may also contain further instructions to the employer, for example to deduct a specified amount from gross pay to take account of special deductions or allowances such as mortgage interest, or to increase each tax deduction by a specified amount to take account of tax on other income, for example emoluments from another employer or income from dividends.

24. The preliminary A-tax notice is based on the taxpayer's circumstances for the pre-preceding year and, once issued, is very rarely amended despite a change in circumstances.

25. On making a deduction from emoluments, the employer must notify the employee of the amount of tax deducted and in January after the income year he must provide the employee with a statement of earnings and the tax deducted.

26. The employer pays the tax he has deducted over to the tax office on six occasions during the course of the year.

27. For individuals who are dealt with under the B-tax system, the tax authority will issue a preliminary notice to the taxpayer by 25 February in the income year and that notice will show the amount of his preliminary B-tax for the year. Generally, this is the same as the finally assessed tax for the pre-preceding year (for example, the 1975 preliminary payments are based on the tax finally assessed on the 1973 income) and payment must be made in six equal instalments in March, May, July, September and November of the income year and in January of the following year. If factors, for example the amount of income, have changed, the taxpayer must notify the tax authorities so that they can make a revised estimate of the tax.

Returns by Taxpayer

28. Individuals must file an annual tax return by 15 February following the end of the income year. No remittance of tax is made with the return. The taxpayer's final liability is then computed, compared with the preliminary tax paid and any overpayment refunded or underpayment collected.

29. The Swedish income tax system is based on every individual (with a few exceptions) making an annual return of income. Generally, one return suffices for national and the three local income taxes but an additional, not a copy, return has to be filed in the municipality, other than the municipality of main residence, in which property is held or the taxpayer maintains a business establishment. The taxpayer does not have to calculate his tax liability for inclusion in the return.

Distribution of Tax from Tax Authorities to Local Authorities

30. Payments are made by the tax authorities six times a year to the counties, communities and parishes on the basis of assessed total income for the year

pre-preceding the income year at the rate of tax applicable to the income year. For example, for 1975 the preliminary payments to a local authority will be the product of the assessed income of the locality for 1973 by the locality's 1975 rate of tax. The local authorities will be informed in mid-August 1976 of the total assessed income for each area and the total tax collected. At that time, the difference between preliminary tax payments and finally assessed payments are adjusted. The tax is allocated precisely to the area to which it is due by means of the code number referred to in paragraph 22 above which identifies the county, community and parish.

Local Authority Budgeting

31. The communities decide their tax rate in November for the year preceding the income year and the budget, for example for 1975, would show:

Adjustment from 1973

Notified income for 1974 (Kr. 10 million)	
x 1973 rate (10%) =	Kr. 1,000,000
<i>Less: Preliminary tax payments made to local authority in 1973 based on 1971 tax base (Kr. 8 million)</i>	
x 1973 rate (10%) =	800,000

Adjustment for 1973 to be paid in 1975 Kr. 200,000

Provisional for 1975

1973 tax base (Kr. 10 million)	
x 1975 rate (12%) =	1,200,000
	Kr. 1,400,000

32. The fact that the 1975 budget tax take is based on the income of the pre-preceding year means that the 1975 rate of tax has to be correspondingly higher as the tax base has not been uplifted to take account of inflation whereas, of course, the local authorities have to bear costs at current prices. Against this, however, the budget for the year will include the final adjustment for local income tax on the pre-preceding year base. However, there appeared to be some resentment amongst local authority associations that tax due to them was being held for a long time by central government.

33. Counties decide their budget one to two months earlier than the communities. Here again, we were informed of the same problem and resentment that communities had regarding the out-of-date tax base for preliminary payments.

34. We were informed by the local authority representatives that the use of the national tax base for local income tax purposes did not present any real problems for local authorities. The reason for this appeared to be that changes in the national taxation structure are infrequent and any major increase in allowances is compensated by payments from national to local government. However, difficulties have arisen this year when national government increased the allowances.

National Aspects

35. We were informed that there was a general concern at the high tax rates operative in Sweden which are steeply progressive.

Examples of the total income tax burdens for 1975, assuming local income taxes amount to 25.23 per cent, are shown in the following tables.

<i>Gross income</i>	<i>Total tax</i>	<i>% of gross income</i>	<i>Marginal rate</i>
<i>Single taxpayer</i>			
Kr. 6,000	Kr. 483	8.1	32.23
15,000	3,384	22.6	32.23
30,000	9,044	30.1	47.23
40,000	14,097	35.2	53.23
50,000	19,720	39.4	63.23
100,000	54,135	54.1	73.23
<i>Married taxpayer (one person earning) without children</i>			
6,000	—	—	—
15,000	1,584	10.6	32.23
30,000	7,244	24.1	47.23
40,000	12,297	30.7	53.23
50,000	17,920	35.8	63.23
100,000	52,335	52.3	73.23
<i>Married taxpayer (one person earning) with 2 children</i>			
6,000	(3,000)	—	—
15,000	(1,416)	—	—
30,000	4,244	14.1	47.23
40,000	9,297	23.2	53.23
50,000	14,920	29.8	63.23
100,000	49,335	49.3	73.23

- (a) There is a cash grant of Kr. 1,500 per child under 16. The cash grant of Kr. 3,000 has been taken into the tax amounts in the above example.
- (b) We were informed that the average wage is Kr. 40,000.

The existence of local income tax at a high flat rate was considered to be a constraint on national government in the matter of reforming the national income tax base to avoid the steep progression instanced above. There was no wish to graduate local income tax rates as this would cause undue administrative complications and it was appreciated that the same result could be achieved by reducing local income tax rates and increasing national income tax rates and also the grants to local authorities, but local independence is strong and such a move would probably be resisted.

Miscellaneous

36. We were not provided with the total costs of collection of the income taxes but were told that they were estimated at 1 per cent of the total tax take. We were not able to ascertain, therefore, the costs of collection of the local income tax portion of the total tax take but were informed that the abolition of local

income tax, which is not contemplated, would only result in a marginal saving in cost.

37. There is speculation in Sweden that the guaranteed amount of the presumed income from property (see paragraph 12 above) will be abolished for both national and local income tax purposes as it is yielding a diminishing proportion of the tax collected. We were not able to obtain any official confirmation of this.

38. Although each of the three tiers of local authorities have complete freedom to fix their own rates of taxation, there was in 1973 and 1974 an agreement between the local authorities and the national government to freeze or considerably restrict the increase in local tax rates and compensatory payments were made to the local authorities by the State. We were informed that this was regarded by some local authority representatives as a severe interference with local autonomy and that it was considered important to relate taxes to the local authority's expenditure in order to retain independent action for the authorities. We were also informed that it was probable that another period of freeze or restricted rates would be operated again in 1976 and 1977.

39. We were informed that there is a committee reviewing the tax system at present, but that the committee is not expected to recommend substantial alteration to the existing system.

BRIEF DESCRIPTION OF LOCAL PERSONAL INCOME
TAX SYSTEMS IN NEW YORK AND NEW JERSEY,
UNITED STATES OF AMERICA

GENERAL FEATURES

The Taxing Authorities

1. The United States of America, with a population of approximately 211 million, comprising 51 States of which 45 levy a corporate income tax and 44 a personal income tax in some form or other.
2. Below the States are counties, cities, towns and school and other districts making in all some 4,000 different taxing authorities administering many different types of taxes which, in many cases, include taxes on personal, corporate, trust and other income.

Taxing Powers

3. States derive their taxing powers from the constitution. These powers are jealously guarded and the State authorities are resentful of any form of Federal interference. The lower tier authorities derive their taxing powers from State legislation and consequently are able to act only within the terms of that legislation which can be amended by the States.

Tax Base

4. About 37 of the States start with income as assessed for Federal tax, or the amount of Federal tax, as the base but in most cases there are then numerous inclusions, exclusions and modifications made to that base. Some States will adjust the tax base by excluding from the State assessment some income which is assessable to Federal tax or include income which is exempt from Federal tax. Many States have their own scales of deductions, allowances and tax rates.
5. Whilst some States have tied their State income tax system to the Federal, in that they levy their own rate of tax on the income as assessed for Federal purposes or levy State income tax as a percentage of the Federal tax liability, the majority of States are reluctant to do this as they consider that it operates as a severe restriction on the State's independence of action.

Collection of Taxes

6. In the majority of cases each authority levying a local income tax collects the taxes due. There are a few municipalities which have agreed to tax being collected centrally by the State but this has not been generally adopted on the grounds that the municipalities then have no control over the costs of administering the tax system. There can be and is delay in remitting tax collected from the State to the municipalities. Their is no control over the tax base, with

consequent loss of independent action, and the municipality has no part to play in the collection of amounts due. In this connection, we were told that in some cases a State may, as a matter of policy, not pursue tax arrears for an industry which was in financial difficulties.

Interaction of Taxes

7. State and other local income taxes are deductible for Federal tax purposes, with certain limitations, but there is no standard pattern for the allowability of other taxes in calculating local authority taxes.

Allocation of Income Between Different Taxing Authorities

8. The operation of localised income tax systems adopting a source basis for business incomes means that persons operating in or deriving income from more than one State must allocate income to the different States or localities. Generally the allocation is made to those areas in which an enterprise has a regular place of business and many of the States adopt the Massachusetts formula which apportions the income on the basis of a formula derived from capital, profits and wages. Because of the different bases operating in various States, such an allocation may mean that more or less than the total income is assessed to local taxes.

Administration

9. Whilst the Federal base is the starting point for many State and lower tier tax systems, the Federal and local tax systems are not integrated and generally there are separate administrative organisations, review and appeal structures and pay and withholding systems.

10. Because of the multiplicity of systems and the independence of the local taxing authorities, it is not possible to provide a short definitive summary of local income taxes as operated in the United States of America. The picture is one of complete independence from the Federal system, considerable variation between the different systems operated by the local authorities, numerous taxes and considerable complication. Consequently, it was necessary to restrict our examination to two States, which we deal with below.

NEW YORK

Taxing Authorities

11. There are three levels at which taxation on income is levied—Federal, State and City. Except that the Federal adjusted income has been generally adopted as a starting point for State and City taxes, the three levels operate almost completely independently of each other. The Federal authorities have no power to interfere in the State or City taxation systems except that the State may not adopt legislation that conflicts with Federal law. The City derives its taxing powers from legislation enacted by New York State but, subject to this and a degree of co-operation in certain matters, the City is independent of the State.

Local Income Taxes

12. The State has independent taxing powers and the main taxes on income comprise:

Corporate Franchise Tax

Personal Income Tax

New York City derives its taxing powers from New York State and its taxes on income comprise:

Corporation Tax

Personal Income Tax on residents

Earnings Tax on non-residents

Persons Liable

13. The liability of individuals to New York State or City income taxes is determined by the following rules, in which the term New York means New York State for State income tax purposes and means New York City for City income tax purposes:

(a) The following are liable to personal income tax:

- (i) residents of New York who are required to file Federal tax returns,
- (ii) other individuals, whether or not resident in New York, whose income from New York sources exceed certain levels, and
- (iii) partnerships, if a partner is resident in New York or if income is derived from New York sources.

(b) Residents are:

- (i) individuals domiciled in New York unless maintaining a permanent place of abode outside New York and not maintaining one in New York, and
- (ii) individuals not domiciled in New York but maintaining a permanent place of abode in New York and spending more than 183 days in the taxable year in New York.

(c) Individuals who are not liable to New York City personal income tax are liable to New York City earnings tax if they:

- (i) earn wages in New York City, or
- (ii) carry on a trade or business, alone or in partnership, in New York City.

Rates of Local Income Tax

14. (a) State personal income tax –

Graduated progressive rates rising from 2 per cent on first \$1,000 of taxable income up to 15 per cent on taxable incomes in excess of \$25,000.

There is, in addition, a surcharge of $2\frac{1}{2}$ per cent of the calculated tax liability.

(b) City personal income tax –

Graduated progressive rates on City taxable income, rising to: 3.5 per cent on income over \$30,000 for taxable years ending on or before 31 December 1975

4.5 per cent plus \$675 on income over \$25,000 for taxable years beginning on or after 1 January 1976.

(c) City earnings tax is levied on employees at a flat rate as follows:

$\frac{45}{100}$ of 1 per cent of wages

$\frac{65}{100}$ of 1 per cent of self-employment earnings

Federal Income Tax Rates

15. Personal: Graduated and progressive up to a maximum of 50 per cent on earned income and 70 per cent on other income.

Bases for Assessment to Local Tax

16. (a) Generally the State and City personal income taxes use the Federal adjusted income as a starting point but there are then many adjustments that may be made. Both the State and the City determine their own personal deductions and allowances which differ from each other and also differ from those used for Federal purposes.

(b) State personal basis:

Residents: Using the Federal adjusted income as a base, various additions and deductions are made and exemptions are applied.

Non-residents: Using income as computed for Federal purposes, the net amounts of income, gains, losses and deductions, derived from or connected with New York State sources are assessed.

(c) City Personal basis:

Generally as for State residents but reading 'City' for 'State'.

(d) City Earnings basis:

Amount of earnings less an exclusion reducing to Nil at \$30,000.

Interaction of Taxes

17. New York State and City taxes on income are allowed as deductions in computing income for Federal tax purposes, subject to certain limitations.

Returns

18. The United States income taxing system is based on every taxable person and entity, with a few exceptions, making an annual return of income. Separate returns are required for Federal, State and City purposes. The returns are complicated and, we were informed, most people need help in completing them.

Assessment

19. A self-assessment procedure operates in that the taxpayer is required to assess his own tax liability for each tier of taxation.

Administration

20. As mentioned earlier, the States, in particular, have a long and strong tradition of autonomy and are reluctant to cede any administrative functions to the Federal authorities. There is the same strong feeling held by lower tier

authorities, such as cities, against ceding any of their autonomy to the States. As a result, each tier generally has its own independent administration, collection, auditing and enforcement structures, although there is, in some cases, co-operation between various tiers on the sharing of information and auditing functions.

Payment of Tax

21. Taxpayers with income other than wages are required to file declarations of estimated tax each year and make payments on account in accordance with those estimates throughout the tax year. Final settlement is made on the filing of the annual tax return and interest penalties are imposed for the underpayment of instalments or delay in making the final settlement.

22. An employer is responsible for withholding tax at source from salaries and wages for City, State and Federal authorities. Additionally, the employer may also need to deduct tax from an employee's emoluments for the employee's State of residence if this is outside New York.

Pay-as-you-go

23. To enable this system to operate, the employee must prepare and sign a statement, which he hands to his employer, scheduling the exemptions to which the employee is entitled. In effect, this amounts to a self-coding system. The employer then deducts tax from the emoluments according to tax tables (one for each tax authority) and the schedule of exemptions supplied by the employee. The employer makes deductions according to the gross pay of the employee and the tax tables take account of the exemptions claimed by the employee. As a safeguard against the employee claiming too many exemptions, there are penalty interest payments exacted for overstatement of exemptions.

24. The employee may also require his employer to deduct additional withholding tax on his earnings to provide for his liability on income other than salaries and wages from the employer.

25. The employer has to pay the tax deducted over to each tax authority separately at regular intervals during the course of the year. At the end of the income tax year the employer must provide a form to the employee showing the gross pay and the taxes deducted.

26. Employers are also required to deduct earnings tax from wages and salaries paid to residents of New York City and account for that tax to the City authorities. These deductions are effected by the use of separate tax tables provided by the New York City tax authorities.

27. The pay-as-you-go procedures may be the subject of audit by any of the tax authorities.

NEW JERSEY

28. The state of New Jersey imposes two forms of tax

- (a) a tax on unearned income and capital gains;
- (b) the 'commuter' taxes.

29. The tax on unearned income and capital gains took effect on 1 January 1975. Its scope is as follows:

- (a) Residents of New Jersey are liable to the tax on all their unearned income and capital gains.
- (b) Persons not resident in New Jersey are liable to other tax on all capital gains arising on the disposal of land or tangible property situated in New Jersey.

The rates of tax are as follows:

- (i) The basic rates range from 1.5 per cent on income and gains up to \$1,000 to 8 per cent on income and gains over \$25,000.
- (ii) Dividends and interest are taxed at half the basic rate.
- (iii) An individual is exempt from the tax if his gross income as computed for Federal tax purposes is less than \$7,500, or \$15,000 in the case of husbands and wives who have elected for joint assessment.
- (iv) Those over 65 and certain categories of disabled person are exempt.

30. There are two commuter taxes:

- (a) The New York commuter tax is charged on income of New Jersey residents from New York sources and upon the income of New York residents from New Jersey sources. The tax rate is progressive, rising from 2 per cent on the first \$1,000 of net income up to 15 per cent over \$25,000. This tax is subject to a $2\frac{1}{2}$ per cent surcharge for some years.
- (b) The Pennsylvania commuter tax is charged at a flat rate of 2.3 per cent of taxable compensation, net gains or net income received or accrued to New Jersey residents from Pennsylvanian sources and upon residents of Pennsylvania from New Jersey sources.

We received the clear impression that these commuter taxes were imposed by New Jersey in retaliation for the taxes imposed by New York and Pennsylvania on New Jersey residents.

**LOCAL PERSONAL INCOME TAX SYSTEMS
OPERATING IN CANADA¹**

A BRIEF DESCRIPTION

Taxing Authorities

1. There are three levels of government in Canada, Federal, Provincial and Municipal. The Federal government and the Provinces levy taxes on income of individuals and corporations but the Municipalities have no such power. The Municipalities raise the largest part of their revenues from the property taxes.
2. During the period 1957 to 1962, the majority of the Provinces surrendered their income taxing rights to the Federal authority in exchange for a standard percentage of income taxes collected from the Province. However, we are informed that because the Federal authority was reluctant to increase the rental grant to the Provinces, the Provinces demanded the return to them of their taxing rights. Consequently the Federal authority reduced the rates of tax that it levied and the Provinces re-assumed their taxing powers.

Basis of Assessment

3. Individuals are subject to Provincial income tax according to their place of residence, but corporations and the businesses of self-employed according to the place of business. This means that the profits of businesses need to be allocated between provinces and this is made according to a formula.
4. A taxpayer's residence as at 31 December in the tax year, which is the same as the calendar year, determines the Province to which he will pay LIT for the whole of that tax year. The principal place of residence on the last day of the tax year is shown by the tax-payer on his annual income tax return. Any differences as to which of two or more residences is the principal residence are settled during the tax assessment process and, we were informed, at a negligible cost in terms of the overall cost of operating the tax system.

Local Income Tax Rates

5. At present all the Provinces levy their own personal income taxes at rates determined by each Province as a percentage of the individual's Federal tax bill. The taxes are collected by the Federal authority for all Provinces except Quebec and paid out to the Provinces as appropriate. The Provincial rates of personal income tax for 1974 range from 30.5 per cent to 42.5 per cent on the amount of Federal tax payable by the individual.

¹ This Appendix was written with particular reference to Ontario. Special rules apply in Quebec.

Federal Tax Rates

6. The Federal income tax rates for 1974 are progressive up to 47 per cent on taxable incomes in excess of \$63,960. The scale of rates was as follows:

12 per cent on first \$	533 of taxable income
18 per cent on next \$	533 of taxable income
19 per cent on next \$	1,066 of taxable income
20 per cent on next \$	1,066 of taxable income
21 per cent on next \$	2,132 of taxable income
23 per cent on next \$	2,132 of taxable income
25 per cent on next \$	2,132 of taxable income
27 per cent on next \$	2,132 of taxable income
31 per cent on next \$	3,198 of taxable income
35 per cent on next \$	10,660 of taxable income
39 per cent on next \$	15,990 of taxable income
43 per cent on next \$	22,386 of taxable income
47 per cent on excess over \$	63,960 of taxable income.

The scale is adjusted each year to take account of inflation. For 1976 the 47 per cent rate applies on incomes in excess of \$78,000.

Individuals Chargeable to Local Income Tax

7. The following individuals are liable to Ontario income tax:

- (a) residents of Ontario on total income (excluding some business income earned in other Canadian provinces) calculated as a percentage of Federal tax;
- (b) non-residents of Ontario on part of the business income earned in Ontario;
- (c) non-residents of Canada on business income arising in Ontario.

Collection Arrangements

8. Under the collection agreement with the Federal authorities, the same tax base has to be used but Ontario and some other Provinces, whilst starting with Federal tax as the base, make a number of adjustments to reduce the tax payable by individuals. These Provincial exemptions and credits are claimed on the Federal tax return and processed by the Federal authorities but this has led to stress between the Provinces and the Federal authorities because the adjustments now being made by the Provinces are becoming too numerous for the Federal authorities to accommodate. The persons to whom we spoke considered that the present system was confusing and costly but the independence of the Provinces is rated sufficiently highly to make these disadvantages acceptable.

Pay-as-you-go

9. In Canada there is a pay-as-you-go system for the deduction of Federal and Provincial income tax from salaries and wages. It works by the employee filing his claim to exemptions with his employer, who then deducts both Federal and Provincial income tax according to tables supplied to the employer. As in the United States and Sweden, the employee may request the employer to increase the amounts deducted from his pay so as to avoid an underpayment of tax at the end of the year, particularly in relation to income from investments or

second jobs, but the employer may not reduce the tax that is shown to be due by the tax tables.

10. For the self-employed and for those in receipt of passive income, the taxpayer must make his own estimate of the tax due for the taxation year and make quarterly payments accordingly. The estimate must not be less than his liability for the preceding year unless there are factors whereby it is anticipated that the actual liability is likely to be less.

Returns

11. At the end of the tax year every taxpayer must file a return of his income and calculate his Federal and Provincial tax payable. The Provincial tax credits are dealt with on a separate form which is sent with the Federal tax return. Since each Province has its own credits, different forms are required for each Province.

Settlement of Liability

12. He also enters on it the amount of provisional tax that has been suffered during the course of the year, either by payments to the revenue authorities or by deductions by employers, and if a balance is due, a cheque for that balance must accompany the return. If there is a refund due to the taxpayer, a refund will be made to him directly. Although the Federal and Provincial taxes are calculated separately, the overall liability is dealt with in one sum and the Federal authorities will apportion the amount collected to the National Government and to the Provinces.

Costs of Collection

13. The Executive Director of Taxation for the Province of Ontario estimated that the costs of collecting both the Federal and Provincial income taxes amounted to 0.91 per cent of the combined taxation yield.

INDIVIDUALS WHO ASSISTED IN OUR ENQUIRIES

<i>Person</i>	<i>Organisation</i>
Sweden	
Herr Tore Lundin	Riksskatteverket (The National Tax Board)
Herr K-E Nilsson	Stockholms stad (City of Stockholm)
Herr Ulf Brynell	Stockholms stad (City of Stockholm)
Fru Lilian Westerberg	Stockholms stad (City of Stockholm)
Herr Rune Wadeskog	Aktiebolaget Statens Skogsindustrier (state owned forestry company with activities in many parts of Sweden)
Herr Rune Farneman	Aktiebolaget Statens Skogsindustrier (state owned forestry company with activities in many parts of Sweden)
Herr Ingemar Egelstedt	Landstingsförbundet (Association of County Councils)
Herr Ingemar Hjelmqvist	Kommundepartementet (Ministry of Municipal Councils)
Herr Erik Hook	Finansdepartementet (Ministry of Finance)
Coopers & Lybrand AB, authorised public accountants	
United States of America	
Mr Sidney Glaser	Director of Taxation, State of New Jersey
Mr Tompkins	New England Regional Audit Office, Internal Revenue Service
Mr Paul Skwiesky	Director of Tax Processing, City of New York
Mr Robert L. Plancher	Tax Director, American Brands Inc.
Coopers & Lybrand, Certified Public Accountants	
Canada	
Mr Duncan M. Allen	Ontario Ministry of Treasury and Economics
Mr Doug Sherbanuk	Canadian Tax Foundation
Cooper & Lybrand, Chartered Accountants	

LIST OF PUBLISHED APPENDICES TO THE REPORT OF THE COMMITTEE OF INQUIRY INTO LOCAL GOVERNMENT FINANCE

IN PRINT

- 1 Evidence by Government Departments**
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- 3 Evidence by Political Parties**
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- 5 Reports on Foreign Visits**
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- 7 Government Grants to Local Authorities: Evidence and Commissioned Work**
- 8 Local Income Tax: Evidence and Commissioned Work**
- 9 Rating: Evidence and Commissioned Work**

IN MICROFICHE: (Appendix 10)

Association of County Councils – Oral evidence

Association of County Councils in Scotland – Oral evidence

Association of District Councils – Oral evidence

Association of Land Valuation Assessors of Scotland (now reconstituted as The Scottish Assessors Association) – Oral evidence

Association of Metropolitan Authorities – Oral evidence

Chartered Institute of Public Finance and Accountancy – Investigation into the charging policies of a sample of local authorities

Chartered Institute of Public Finance and Accountancy – Local government accounting practices in England, Wales and Scotland

Convention of Scottish Local Authorities – Oral evidence

Council for the Principality – Oral evidence

Dr B Davies – Variation in expenditure and need: personal social services

Department of the Environment – Oral evidence

District Auditors – Oral evidence

Dr A W Evans – Commentary on the effect of changing the basis of rating domestic property from rateable values to capital values, based on data from the 20 per cent sample survey of sales of dwellings reported to the Inland Revenue

Mr C D Foster, Mr R A Jackman and Mr M J Osborn – Centralisation and local discretion in educational expenditure

Greater London Council – Oral evidence

Prof G Houston – Commentary on aspects of agricultural rerating

London Boroughs Association – Oral evidence

Mr J P Macey – Local authority housing finance

Mr D Mair – Report on the rating of non-domestic subjects

Ministry of Agriculture, Fisheries & Food – Oral evidence

National Association of Local Councils – Oral evidence

National Farmers' Union and National Farmers' Union of Scotland – Oral evidence

Research Surveys of Great Britain Ltd – Report on survey of public attitudes

Scottish Office – Oral evidence

Mr P J Taylor – Papers on the incidence of local rates in the United Kingdom

Valuation Office, Inland Revenue – Oral evidence

Welsh Counties Committee – Oral evidence

Welsh Office – Oral evidence

Mr H M Wilks – Oral evidence

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